October 2008

The Pensions Regulator

Statement to trustees about current financial pressures

Developments in financial markets will be of great concern to trustees, their sponsoring employers and scheme members. This statement sets out our general position.

Defined benefit (DB) schemes

* Our contacts with larger pension schemes suggest a relatively limited direct exposure to so called 'toxic' assets and limited involvement in derivative trades with counterparties that are in difficulty.
* While a few individual pension schemes may have higher levels of exposure, we have not been informed of any significant problems and we do not believe the issue is systemic.
* Our existing codes of practice highlight the importance of trustees having structures in place to monitor their investment portfolio and identify any issues that arise on a regular basis. Trustees should ensure that this best practice continues to be followed in the current climate in relation to the overall investment approach and in relation to exposure to the 'toxic' asset classes.
* The main issues faced by pension schemes are likely to be firstly the more general fall in asset values, and secondly the emerging pressures on company covenants and ultimately solvency.
* Clearly some schemes will be more affected than others.

Scheme funding

The impact of both falling asset values and weakening covenants falls within the framework of the regulator's scheme specific funding regime put in place following the Pensions Act 2004. The approach set out in UK legislation balances scheme funding levels with affordability for the employer. We have reviewed our approach to the implementation of scheme specific funding in the light of the current economic conditions, and believe it remains fit for purpose.

At this time we have no plans to change our Codes of practice or make other specific announcements in relation to current market events. This is on the basis that the principles in the *Code of practice: Funding defined benefits* are intended to work across a range of economic conditions, and we consider that they remain valid. However, we are in unprecedented times and our approach will be kept under review.

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Recovery plans

We have no immediate evidence that suggests significant numbers of employers are failing to meet their commitments under agreed recovery plans. Indeed, recently received recovery plans have shown shorter recovery periods and many fewer plans have triggered than in the first year of the new regime. These plans were agreed in relatively benign economic conditions, but it is clear that trustees and employers have adjusted to the scheme specific funding regime. We expect to report more fully on the latest tranche of recovery plans in December.

For those recovery plans that are already in place our existing scheme funding code of practice states that trustees should consider reviewing and, if necessary, revising plans where there is a significant improvement or decline in the employer's covenant (paragraphs 131-132). It is good practice for trustees to keep the employer covenant under review, and trustees must judge whether their existing plans and processes in this area are adequate, given current conditions. Where an employer believes that an existing recovery plan is at serious risk of jeopardising the company's future development or solvency that will be a matter for discussion with the trustees. The trustee board will wish to consider carefully any proposal for change taking into account among other things plans for payments to other creditors and dividends to shareholders. Where a revision to the recovery plan is agreed, the regulator must be informed.

Trustees may wish to review the guidance available to them on their duties in respect of funding defined benefits available on our website:
www.thepensionsregulator.gov.uk

Our funding 'triggers'

The legislation and government policy do not expect us to set funding targets. But our risk-based approach requires a means of sifting out and identifying risk. We have adopted 'triggers' on key aspects of the plans, such as length of recovery periods that can lead to greater scrutiny of the plans. The triggers we have in place are expected to remain unchanged.

We have emphasised previously that these triggers are not targets: we anticipate that recovery plans arriving in 2009 may show larger deficits and weaker covenants due to the current economic difficulties. This is likely to imply higher technical provisions and may result in longer recovery periods being proposed, recognising the emerging pressures on company cash flows and thus affordability. Our operational processes will continue to reflect the conditions in which recovery plans were produced.

Defined contribution (DC) schemes

* Members of DC schemes have more responsibility for the final outcome of their pension fund.
* It is important for them to carefully review their pension fund in the light of their current circumstances to decide if they need to make any changes at the present time (eg to the fund(s) in which they are invested, their level of contributions, or their target retirement date).
* In trust-based DC schemes, trustees should refer to our current guidance on member communication.
* Members in contract-based DC schemes should be encouraged to contact their provider and refer to the Financial Service Authority's *moneymadeclear* website: **www.moneymadeclear.fsa.gov.uk**

Trust-based schemes

Trustees of DC schemes may want to give careful consideration to their member communications at this time – ensuring that members have full knowledge of their options, are prompted to review their position in light of their circumstances and are directed to seek advice where appropriate. The Pensions Advisory Service (TPAS) exists to provide advice and information. Trustees may also want to review the position of member segments that may be at particular risk due to current economic conditions. Identification of these segments will depend on the scheme rules and investment options members have open to them.

As with DB schemes, the regulator has a range of guidance that trustees may find useful. In particular, our guidance states that trustees of DC schemes should have clear and appropriate processes in place for members approaching retirement. This is very important for members approaching their target retirement age at this point in the economic cycle. Such processes should include the provision of information on options and direction to appropriate advice. The information and advice should cover the impact of timing on decisions to purchase annuities.

The legal requirements on the open market option for annuities are also an important aspect of this information. It is possible that by exercising the open market option they may obtain a higher annuity rate than offered by their pension provider.

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Lifestyling

Where a scheme operates lifestyling (ie moving into less volatile assets as the member approaches retirement) those assets already switched will have had some protection from recent market fluctuations. Where lifestyling is ongoing, the value of assets being switched will in many cases be lower than they might have been a few months ago. In these circumstances trustees may want to remind members to keep their choices under review.

Contract-based schemes

In contract-based DC provision, where trustees do not exist, employers may want to encourage employees to engage with their providers to address these issues. The voluntary employer engagement process from our guidance provides useful suggestions for managing this process.

We will continue to keep the situation under review, and would encourage trustees to contact the regulator with any concerns.

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