

Pensions Watch – March 2009

Quantity rather than quality

The collective deficit of those 7,800 defined benefit (DB) pension schemes insured by the Pensions Protection Fund's (PPF) safety net rose from £190.6bn in January to a record £228.1bn in February. This was largely as a consequence of gilt yields – which the PPF uses to value scheme liabilities – falling in anticipation of the Bank of England's Quantitative Easing programme (QE for short) that began on March 11th. In purchasing £75bn of five to 25 year gilts over the 3 months (contrast this with plans for the Debt Management Office to issue £147.1bn of gilts during the financial year 2009/10), the Bank's intention is to drive down gilt yields so as to lower the cost and hopefully increase the availability of finance to companies. However, QE is already proving to be a double-edged sword as scheme sponsors may have to devote more company cash to plugging increased DB scheme deficits and financing a rising PPF risk-based levy, which is partly based on the size of each scheme's PPF liabilities. In fact, the fall in gilt yields since QE began may well have added another £80bn to scheme liabilities given the number of schemes now valuing their scheme liabilities with reference to gilt, rather than corporate bond, yields.

Pick a number

Moving from the private sector to the public sector, according to independent pension consultant John Ralfe, the 81 funds that comprise the English Local Government Pension Scheme (LGPS) had an actuarial deficit of a mere £23bn as at March 2007. However, this official deficit was calculated on the basis of the scheme liabilities being valued according to the expected return on the underlying assets held, which principally comprise equities. (This is how private sector DB pension scheme liabilities used to be valued before the implementation of accounting standard FRS 17). By fast forwarding to February 2009 and changing the accounting basis to that of FRS 17, the collective deficit increases to about £80bn through a combination of falling asset values and rising liabilities. However, as the LGPS is ultimately guaranteed by central government, arguably these liabilities should be valued in relation to the ultra low yield on ultra-safe index-linked gilts. The result? You guessed it - a deficit number that very probably begins to rival that of the private sector.

Trustee governance back under the microscope

Against the backdrop of the need for trustees to more objectively assess the sponsor covenant and meet more frequently amidst the market turmoil to make quicker investment decisions given the increasing array of tactical investment opportunities arising from market dislocations, trustees are unsurprisingly making substantially greater demands on their consultants to make good the shortcomings in trustee governance structures. Linked to this development has been an increase in schemes appointing a dedicated Chief Investment Officer (CIO) and the move towards fiduciary management –

fiduciary managers design, implement and monitor scheme investments - as the complexities of asset management demand ever greater levels of trustee governance.

Myners' call for more active engagement

At this year's NAPF investment conference, Lord Myners listed the failure of institutional investors – principally pension schemes and asset managers - “to adequately scrutinise and monitor the decisions of [company] boards and executive management and hold them accountable for their performance” as one of the key failures of the past 18 months. No sooner said, Merseyside and North Yorkshire pension funds will be the lead plaintiffs in a class action lawsuit against the Royal Bank of Scotland (RBS) in New York, in an attempt to improve corporate governance at the under fire bank as well as retrieve losses sustained by the two schemes, claiming to have been falsely reassured about the bank's finances when it was technically insolvent.

...and finally

Swap shop

The London Pension Fund Authority (LPFA) is one of a number of schemes looking to capitalise upon the dramatic decline in inflation and interest rates by locking in the gains from interest rate and inflation swaps executed three years ago to prudently hedge the scheme's interest rate and inflation risk. In the LPFA's case, the intention is to shift from interest rate and inflation hedging to hedging probably the greatest risk that most schemes run: longevity risk.

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