

## Death by a thousand cuts

June 2009 will be remembered by many pensions professionals as the point at which the future viability of the defined benefit (DB) pension scheme came under serious threat, as blue chips BP and Barclays made sweeping changes to their DB schemes. The £11bn BP scheme, with a 2008 IAS19 surplus of £1.58bn, announced it will join the 16,000 other UK DB schemes since 2000 that have closed to new members, by closing its own scheme to new members from April 2010, in an attempt to avoid the costs of sharp and unexpected rises in longevity. Meanwhile, the Barclays DB scheme, with a 2008 IAS19 deficit of £2.2bn, will shortly close to its, near 18,000, existing members and be replaced by a defined contribution (DC) scheme with built-in capital protection. In addition, Barclays is one of 15 FTSE 100 companies whose pension scheme liabilities exceed the firm's stock market value.

Many in the industry are asking what chance there is for smaller, less well advised schemes if blue chip pension schemes such as these, with access to the best advice money can buy, cannot make ends meet? Indeed, almost a third of the 117 DB scheme trustees surveyed in the annual Aon Consulting survey believe their fund will be wound up within the next 10 years, with over one third saying their scheme sponsor would cease future accruals.

No wonder the latest Office for National Statistics (ONS) Pension Trends report suggests that the number of people contributing to DC schemes – both personal pensions and company sponsored schemes – which jointly stood at 7.8m in 2007, will soon exceed the 7.9m-strong active membership in 2007 of private and public sector DB schemes.

Not that such thoughts only pervade the minds of UK pension professionals. In the US, the DB scheme of the once mighty General Motors, with assets of \$91bn and a near -\$100bn of liabilities, faces an annual pensions bill of \$9bn, as pension and healthcare costs outweigh the cost of the steel used in every car that comes off the Detroit production line.

## Deficits fall in May

The aggregate deficit of the 7,800 DB schemes insured under the Pension Protection Fund's (PPF) industry financed safety net shrank from £188.5bn at the end of April to £179.3bn at the end of May. However, this improvement pales into insignificance against the aggregate £51bn surplus recorded as at the end of May 2008.

## Solvency management

According to Pension Capital Strategies, FTSE 100 sponsored DB schemes had £86bn wiped from their funding levels in the year to 31 March 2009. Arguably, many of these losses could have been avoided had these schemes employed a solvency manager, who, in monitoring scheme funding levels daily, is charged with moving the scheme's return-seeking assets to liability matching investments as the funding level improves.

## TPR sends valuation warning to sponsors

The Pensions Regulator (TPR) has told sponsoring employers of DB schemes that they must be more realistic in the selection of discount rates in valuing scheme liabilities. The higher the discount rate applied, the smaller the reported value of the liabilities and so the smaller the apparent deficit to be funded. Indeed, KPMG, in its 2009 Pensions Accounting survey of 300 DB schemes, found a 0.4% gap between the discount rates applied in 2008 by the average of the top and bottom quartiles of the schemes surveyed against a 0.1% difference in 2007. In addition, the survey reported that since 2004, scheme longevity estimates have risen by an average of three and a half years, with increasingly fewer sponsoring employers basing their longevity estimates on the outdated assumptions of the actuarial PA92 Medium Cohort tables. Some good news at last!

## Buyouts decline

The sharp rise in corporate bond yields, resulting from the collapse of Lehman Brothers last September and which has made new buyout deals more expensive, was, according to actuarial consultants Lane, Clark and Peacock (LCP) in their annual buyout report, responsible for the marked decline in the buying out of DB pension scheme liabilities during the first quarter of 2009. Consequently, LCP expects the £8bn of buyout business transacted in 2008 to halve in 2009. Against the backdrop of declining business levels, buyout specialist The Pension Corporation failed in its attempt to takeover one of its key competitors, Paternoster, which has voluntarily withdrawn from conducting any future buyouts.

## 2012

2012 should be a year to remember what with the London Olympics, oh and Solvency II, the proposed EU Directive, which, amongst other things, will require insurers to more aggressively back the provision of pension annuities with increased capital requirements. The end result could be a 20% reduction in the retirement incomes paid from defined contribution (DC) pension pots. Subject to the European pensions industry making its collective voice heard, the European Parliament will implement Solvency II in its currently proposed form early in 2010, with its full effects being felt in 2012. 2012, of course, also marks the introduction of Personal Accounts, which will seek to make DC pension provision a reality for around 10m low and middle income earners.

### Age concern

A Financial Times survey of 1,126 adults conducted in early May suggests that 60% of Britons are prepared to work beyond state pension age to receive a bigger pension though 13% are strongly opposed. 39% expected most of their retirement income to come from private pension provision, 32% from state pension/social security and 7% from the sale of property.

## OECD warns of social crisis

The Organisation for Economic Co-operation and Development (OECD), the Paris-based club of rich nations, has warned of an impending social crisis, which could span decades, resulting from strains in the provision of public and private sector pensions. The OECD has called for governments to "reform pension systems now to make them both affordable and strong enough to provide protection against market swings [so as to] save governments a lot of financial and political pain in the future."

### Who wants to be a millionaire?

The House of Lords lambasted the government for the excessively high marginal tax rates that could be imposed on high earners as a result of the recent Budget pension reforms. In their report, the Lords went as far as citing an example, provided by the Confederation for British Industry (CBI), where a marginal tax rate of 145% could result.

And finally...

### Who wants to be a millionaire? (Part 2)

The £9bn Strathclyde Pension Fund reinstated its stock lending programme in April with a view to making a million pounds by taking advantage of so-called "dividend arbitrage" trades executed by hedge funds during the European dividend paying season, which runs throughout April and May.

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