

Lies, damn lies and statistics

The aggregate funding of those 7,800 UK private sector defined benefit (DB) pension schemes, covered by the industry funded Pension Protection Fund's (PPF) safety net, recorded a £0.3bn surplus in March - the first surplus since June 2008. This followed the posting of a £15.1bn deficit in February and was principally attributable to rising gilt yields. However, according to Aon Consulting the aggregate deficit of the UK's largest 200 DB schemes rose to £94bn as ballooning scheme liabilities, resulting from tumbling AA-rated corporate bond yields, outpaced rebounding asset prices. Separately Pensions Capital Strategies estimated the combined deficit of FTSE 100 DB schemes to be £92bn.

A unique situation?

Uniq, the former Unigate business and Marks and Spencer's biggest sandwich supplier, reported a DB pension scheme deficit of £436m at March 2009. Whilst such a figure might not seem out of the ordinary, when compared with its stock market capitalisation of £25m and scheme assets of £500m, the gravity of the situation becomes immediately apparent. Moreover, with 21,000 DB scheme members but only 2,200 staff, none of whom are contributing members, and with no contingent assets to pledge, Uniq has limited options. The Financial Times described Uniq as "all bread and almost no filling". Uniq has proposed to The Pensions Regulator (TPR) that it transfer its scheme assets and liabilities to a ringfenced "shell" company, suspend contributions to the scheme for three years, grow the company through shareholder funded acquisitions and then make contributions based on 33% of the, by then, expanded company's earnings or £10m per annum. This would result in a 50 year recovery plan. Suffice to say, TPR would, by accepting such a recovery plan and allowing the scheme to be transferred to a dormant ringfenced company with no business operations, be going against its own implicit guidelines. However, whilst TPR probably has little choice, it obviously risks setting a dangerous precedent as Uniq is unlikely to be unique.

If the cap fits

Owing to an obscure clause in Cadbury's DB scheme trust deed, its new owner Kraft Foods is unable to make any "unfair or materially detrimental" changes to the company's DB scheme, effectively rendering it near impossible to close the scheme. Consequently, the scheme's 3,600 active DB members have been told they must not only increase their contributions from 5 per cent to 9 per cent over the next four years but also accept a three-year pay freeze, thereby placing a cap on the future accrual of scheme benefits. Meanwhile, the AA has proposed a more generous 2.5% cap on pensionable salary for its 3,000-plus active DB members in addition to

proposing an increase of 1.5% in member contributions. Originally a more stringent 1% cap was suggested. Marks & Spencer was the first prominent DB scheme to adopt the capping of pensionable pay in February 2009, which has since been emulated by other large DB schemes such as that of the Lloyds Banking Group and RBS.

Could risk sharing save DB schemes?

The Department for Work and Pensions (DWP) has issued a note on the risk sharing options available to those employers considering making changes to their DB schemes in an attempt to ensure the latter's sustainability. The note features case studies from five employers featuring six types of risk and cost sharing: hybrid schemes (Barclays Bank), career average earnings (Morrisons), longevity adjustment factor (John Lewis), changing accrual rates and increasing normal pension age (BT) and cost sharing/capping (Civil Service).

DB asset allocation

According to the 700 DB schemes surveyed by consultant Mercer, against the backdrop of robust gains from equity markets, the allocation to equities over the past 12 months has fallen from 54% to 50%. However, whereas only 1% of this shift was allocated to bonds, with many schemes having taken profits from corporate bonds during the second half of 2009, 3% was used to bolster the allocation to alternative assets, such as hedge funds, private equity, commodities and currencies.

De-risking a priority

Research by MetLife Assurance, the bulk annuity provider, suggests that 64% of occupational scheme trustees now believe de-risking has become a greater priority following the economic events of the past 18 months.

Separately, according to consultant Mercer, of the UK's £915bn private sector DB assets, 69%, or £630bn are earmarked to pay pensions to DB scheme deferred members and pensioners – the very liabilities that have a more immediate need to be hedged against higher than expected inflation given that their preservation and payment respectively are RPI-linked. Although most DB schemes continue to give inflation swaps a wide berth owing to their being both expensive in absolute terms and relative to index linked gilts, with the March headline RPI coming in at 4.4%, despite much lower expectations, this has certainly given trustees something to think about.

Public sector pensions

Last month Pensions Watch reported that the official cost of financing MPs pensions is £17,000 per annum greater than the official cost to the taxpayer of £13,000 per MP. This is principally a consequence of the £291m Parliamentary Contributory Pension Fund having a £127m shortfall, which must be funded by the Treasury, ie the taxpayer. This, in turn, is as a result of MPs being guaranteed a lifetime index-linked annuity equal to two-thirds of final salary in exchange for contributing £300 per month to the scheme and winning three elections.

Meanwhile, according to the Pensions Policy Institute the annual cost of providing pensions to members of the Police Pension Scheme has risen by 50% from £1.3bn in 2004-05 to £2bn in 2008-09 – a fifth of the Police Force's total annual budget. This is as a result of benefits now costing 35% of pay given that the average police officer retires at age 51.3.

Consequently, the CBI has renewed its calls for a review of public sector pensions that cover 6.5m people: 2.75m active members, 1.59 deferred members and 2.13 pensioners.

DC to gain prominence

Despite only £5bn having been invested in UK DC schemes over the past 3 years against £100bn into UK DB schemes, Towers Watson believes that by 2020 DC schemes will be second only to Sovereign Wealth Funds (SWFs) as the most influential global investment pools. In the UK this will be as a result of DB membership continuing to cede to DC and as NEST gains traction amongst lower and middle income groups.

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New yardstick for DC default funds

FTSE Group and PensionDCisions have launched five indices designed to benchmark the performance of multi-asset defined contribution (DC) default funds, whether operating in their accumulation, pre-retirement or decumulation phases. However, as these indices only cover those funds that invest in equities, bonds and cash, they are not suitable for the new breed of diversified growth funds that also invest in property and alternative assets.

Separately, PensionDCisions found that over 50% of large DC schemes plan to review or change their default fund investment strategy within the next 12 months. 82% of members on average were found to invest in the default option. 62 schemes, representing 630,000 members and £10.7bn under management, were surveyed.

And finally.....

Hasta la vista baby?

Looking further afield, independent analysis of California's three big public pension funds by the Stanford Institute for Economic Policy Research estimates a shortfall of more than US\$0.5 trillion (£323bn)...all from just a single US state, albeit one that is often cited as the world's 8th largest economy by GDP and governed by a certain Mr Arnold Schwarzenegger since 2003.

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