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DEFINED BENEFIT PENSIONS - TIME FOR EMPLOYERS TO BREATHE?

PENSIONS

The Pensions Regulator has just issued its *Defined benefit annual funding statement 2013*. It references the recent Government announcement of an intention to shift the balance of regulation in favour of private sector investment and growth. In five short pages, the words "flexible" or "flexibilities" are used six times. Does this slight linguistic tilt signal a watershed in regulatory policy?

For all of our clients wrestling with the difficulties of managing legacy defined benefit schemes – whether they are employers or trustees – the annual funding statement has traditionally been an opportunity to "read the runes" in seeking to second-guess what reaction trustees are likely to get from the Pensions Regulator when they submit their next recovery plan. On our own reading of this year's statement, we discern a subtle shift in tone and language which we believe may serve to reduce some of the tensions which have built up between employers and trustees in negotiating funding plans during the last few years.

The statement follows the announcement in the Budget in March 2013 that the Pensions Regulator is to have a new objective to "support scheme funding arrangements that are compatible with sustainable growth for the sponsoring employer". The exact terms of the new objective are yet to follow. The Pensions Regulator will also be required to revise the Code of Practice on Scheme Funding with its new objective in focus. This will follow early in 2014.

The annual funding statement anticipates these changes. It references the recent Government announcement of an intention to shift the balance of regulation in favour of private sector investment and growth.

It also refers to an analysis, published alongside, of the expected positions of defined benefit pension schemes with 2013 valuations, highlighting the impact of the change in market conditions, principally the historically low gilt yields.

KEY STATEMENTS:

- Trustees may need to make greater use of the flexibilities available given market conditions.
- Trustees can use the flexibilities available in setting the discount rates for technical provisions, namely using the yield on assets held by the scheme or anticipated future investment returns in addition to or instead of gilt yields.
- Trustees may change assumptions and contribution requirements provided they document the reasons for the change.
- In setting contribution levels trustees should take into account what is reasonably affordable for the employer.
- Trustees may need to consider lower contributions and longer recovery plans.
- Trustees should avoid damaging any future plans that grow the covenant to the scheme.
- Trustees may allow for an appropriate level of risk that is neither overly prudent nor overly optimistic.
- Trustees should take an integrated approach to covenant, investment and funding risks.

Strictly, there has been no change in the law and no change to the Code of Practice. None of the above is officially new.

However, in five short pages, the words "flexible" or "flexibilities" are used six times. The words "afford" and "affordable" appear four times. Does this signify a watershed in regulatory policy? Is this a signal that employers can ease off from the Sisyphean task of funding legacy defined benefit pension schemes to get on with the pressing matter of growing the business?

The shift is a slight one but there is at least acknowledgement that gilt yields are not necessarily the correct measure for liabilities, that long term liabilities can be met with long term funding and that excessive prudence is unnecessarily damaging for jobs and growth. In pensions small shifts often make a big difference. We look forward to seeing how this shift translates into the outcomes of the next round of funding negotiations.

CONTACT DETAILS

If you would like further information or specific advice please contact:

CAMILLA BARRY

DD +44 (0)20 7849 2238

camilla.barry@macfarlanes.com

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