

Deteriorating financial position of UK companies will exacerbate conflicts of interest on trustee boards

- Any pension surpluses may encourage companies to reduce funding
- Inflation adds £56 billion to pension liabilities

Conflicts of interest on trustee boards could be strained even further as companies look to reduce funding levels of pension schemes even as their financial positions deteriorate in the wake of the global downturn, warns Trustee GAAPS, the trustee search and selection firm.

According to Trustee GAAPS, trustees will need to guard against directors taking a short-term view and cutting funding levels because, although many schemes are currently in surplus, the risks to funding levels is growing.

The Pension Protection Fund (PPF) June index of the 7,800 largest schemes shows that scheme assets have fallen by 2% over the last year to £851.8 billion. Meanwhile, rising inflation is calculated to have added £56bn onto company pension liabilities in the last year (the amount pension funds must pay to retired members goes up as prices rise).¹

David Johnson, Consulting Director, Trustee GAAPS, comments: “As the financial strength of UK companies weakens with the downturn the temptation to cut funding for pension schemes as part of wider cost-cutting measures will increase. The existence of surpluses built up over the last few years in some schemes, will make that temptation even harder to resist.”

“The conflicts of interest of being a trustee and a director of a sponsoring company are hugely amplified in these difficult financial circumstances. Trustees in this position must struggle to secure the long term funding of schemes with one hand, while ensuring short term financial returns for shareholders with the other.”

He adds: “Further market turmoil could easily undermine the financial position of schemes, piling even more pressure on trustees to maintain funding levels. If inflation breaks the 4% barrier, it will heap billions more on the liability of schemes.”

Trustee GAAPS points out that trustees are already becoming jittery about the precarious financial position of sponsoring companies and the potential threat to payments into schemes.

¹ Figures by Redington Partners

Bradford & Bingley, for example, has pension liabilities of £589.8 million, but a market value of just £289 million.

According to research by Mercer, the number of pension fund trustees commissioning independent covenant reviews has jumped by 55% in the past year, to 28% of all trustees.

Trustees of Trinity Mirror's pension funds recently appointed advisers to test the financial strength of the company as its market value fell below £500 million.

David Johnson says: "This is something we are going to see much more of in the current climate. Independent covenant reviews will become an increasingly useful tool for trustees as the business plans of companies get into debt."