

Poor contingency planning can take its toll...

By David Johnson, Consulting Director, Trustee GAAPS

The US sub-prime meltdown and ensuing financial market chaos is now serving as a timely wake-up call for pension fund trustee boards about the need to adopt more rigorous contingency planning to protect their funding plans. Unforeseen events, such as the sub-prime meltdown, can significantly challenge the underlying assumptions on which these funding plans are based. Over 10 years of economic growth can sometimes make us forget that!

The seizing up of the credit markets indicated just how quickly an “acceptable” level of gearing could become “unacceptable”. Just as global markets seemed to be riding the crest of a wave, an increasing number of pension funds could once again find themselves in financial jeopardy. Many trustees are now realising just how fragile their planning has been.

Company boards have had to become experts at grappling with the ‘known unknowns’ and seeking out potential new threats and have evolved much better contingency plans in recent years – so it is time for pension fund trustee boards to catch up.

For contingency plans to be effective they should cover a wide range of scenarios from uninvited takeover or merger approaches to financial difficulties faced by the sponsoring employer and changes in the investment markets. This will allow the pension fund to react expediently to a wide range of situations and ease the pressure placed on trustees.

If the current philosophy on pension fund management persists, there is a danger that pension funds will become ever more at the mercy of economic forces that move across borders at ever faster rates.

The belief that independent professional trustees provide the best solution is gaining more and more weight as it becomes apparent that the role of the traditional fund trustee is increasingly complex and is not always compatible with a normal ‘day’ job. A large number of trustees, whilst efficient at their ‘second’ jobs, simply do not have the necessary qualifications, experience and most importantly, time to prepare for eventualities that can deteriorate at an alarming speed.

Trustees are now not only expected to take charge in a crisis and avert impending disaster, but they are also expected to ensure procedures are in place in case of any event that may lead to a significant deficit in the fund.

Putting in place contingency plans is now often one of the first tasks that independent professional trustees are asked to undertake when they are appointed to pension fund boards.

The sub-prime meltdown is one crisis that few pension fund trustee boards could really claim they were prepared for. Only history will judge how dangerous that oversight has been; however the warning bell has tolled and it should be heeded to avoid further crises.

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