

## THE BUSINESS ISSUES OF CORPORATE PENSION SCHEMES

### Introduction

Many SME's have a company pension scheme, for either some or all employees. They want to be seen to be a "caring" employer, making sure that their employees will also recnt a reasonable income after retirement.

In the 1970's and 1980's, many employers set up final salary schemes, which were OK as investment returns were good and the required employer contributions tended to fall – many employers had several "contribution holidays" of course. That was until the mid/late 1990s when inflation came under control, investment returns fell, and actuaries started to report dramatic improvements in longevity.

### Legal loopholes removed

Faced with increasing, and ultimately unacceptable costs, some employers walked away from their under-funded final salary schemes, leaving the members to suffer benefits which were far less than their anticipated 100% - typically it might have been only 30-40% of what members were expecting.

Whilst this was certainly immoral, it was, at the time, legal. But legislation was introduced which made it impossible for employers to walk away from their unfunded final salary schemes.

### So what can a company with an under-funded final salary scheme do?

Generally the first piece of advice is to take a long hard look at the situation. In particular, get **facts**. What is the true funding position? Is it causing a cash flow problem for the company, or are the pension contributions (albeit a high percentage of pensionable salaries) only a minor business expenditure, as only a small number of employees are in the final salary scheme? Who are the trustees? How are the assets invested?

### What are the options?

Often the first action to take is: stop digging! Stop allowing new members to join the scheme (but Contracts of Employment will need to be checked). Consider ceasing future accrual for existing members. But remember – these will be unpopular measures and the scheme's legal documents will need checking to make sure that what is proposed is legal. Communication (not only what is said but the way it is said) to members and other employees will be critical.

### Is the driving force control of pension costs or a significant reduction in pension costs?

In many cases the responsibility for pensions has passed from the HR Department to the Finance Department and the real desire is to significantly and permanently reduce pension costs.

The problem is that pensions are expensive. A £1pa pension at age 60 requires £25+ of capital. So a scheme whereby the member and company each put in say 3% of salary each year will produce a very low level of pension. Something like a total of at least 20% pa normally needs to go in – which might be 7% by the member and 14% by the company on a 2:1 basis.

### What is the replacement scheme?

It will almost certainly be a defined contribution arrangement. The level of contributions paid by the employer will depend on the answer to the above paragraph i.e. are they cutting costs and putting in a minimum scheme or do they want known and controllable costs but are willing to pay in quite significant contributions?

There is a noticeable trend towards the Corporate SIPP. This is attractive to many companies as the company pension scheme is then not associated with or aligned to a particular insurance company, and the risks to the employer are eliminated. See our separate leaflet on the Corporate SIPP.

**An asset or a liability?**

In most companies, the pension scheme is seen as a liability. It can affect the sale of the business (remember Marks and Spencer or W H Smith, for example). It will definitely affect the value of the business.

**Whose has responsibility?**

It is usually in practice a joint responsibility between the directors of the company and the trustees of the pension scheme. It is normally in the interest of all parties that directors and trustees work together to get the pension scheme under control and properly funded over a reasonable period of time.

**Conflicts of interest**

It has historically been common for directors and officers of the company to also be trustees of the pension scheme.

This now frequently leads to conflicts of interest – see our separate leaflet on this.

**Independent Trustees**

Because of this, more and more schemes are appointing Independent Trustees to their scheme – either as sole trustee or, more commonly, joint trustee with the existing trustees.

We can assist in the area of Independent Trusteeship. Please just ask for more information.

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