Developments in pension fund financing

LONDON, UK: Corporate assets are set to overtake cash as main financing source for pension scheme shortfalls as companies looking to repair defined benefit pension scheme deficits begin using assets more than cash contributions over the next year, according to analysis by PricewaterhouseCoopers LLP (PwC).

Almost a fifth of FTSE 100 companies have now used some form of asset to cover pension scheme deficits, whether paid directly into the pension scheme or held in an intermediate vehicle as security for contingent payment on some future event. Such asset deals were estimated to be worth £8 billion (about R90 billion) over the last year, compared with an estimated £12 billion (about R134 billion) of direct cash contributions.

Assets set to overtake cash

With a further 30 FTSE 100 companies seriously considering non-cash financing solutions, assets are set to overtake cash as the main financing source for pension shortfalls. PwC predicts asset deals will reach more than £10 billion (about R110 billion) over the next year, with annual deficit cash contributions falling back from their recent spike to less than £10 billion (about R110 billion).

Raj Mody, pensions partner and chief actuary, PricewaterhouseCoopers LLP, commented: "We have reached a tipping point whereby asset deals are becoming a primary method of plugging pension scheme deficits. The shift reflects the competing range of challenges facing companies tackling deficits: corporate liquidity is still under strain, while pension scheme trustees are demanding ever more prudent funding targets. Meanwhile companies are having to do more to prove the strength of their business to trustees, particularly as a result of recent guidance from the pensions regulator."

"Non-cash funding arrangements can address a number of these points all at once. They are a tangible demonstration of sources of value the company can deploy to give security to the pension scheme. They help bridge the gap between current funding levels and longer-term funding targets, often in an accelerated way compared to more gradual or back-end loaded cash contribution schedules. And they obviously free up cash for other purposes such as continued investment in the sponsoring business. As a result there is growing recognition by companies and trustees alike of the benefits of non-cash funding, along with increased prevalence of these structures."

Valuing assets can be complex

Under these arrangements, assets ranging from bonds to brand royalties, real estate to receivables, stocks to subsidiaries, are paid directly into the pension scheme or used as security payable in the event of a default or insolvency for example. The enhanced security and value enables trustees to reduce or defer demands for cash contributions from the sponsor.

Valuing assets for non-cash funding can be complex, particularly as companies are likely to look at an ever widening range of commodities to use.

Adam Sutton, valuations director, Pricewaterhouse Coopers LLP, added: "The values of copyrights, patents, loans, and real estate are impacted by many different factors. For example, real estate would typically be minimally impacted by deterioration in the performance of a company. By contrast, a trademark may have a significant value while the business is a going concern but this could reduce significantly with a decline in corporate performance, and disappear altogether in an insolvency scenario. Valuing and managing these assets appropriately is of paramount importance in protecting the interests of all stakeholders."