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"The UK's system of pension regulation is called into question"

http://www.ft.com/cms/s/0/1e99ecbc-322f-11e6-ad39-3fee5ffe5b5b.html#

In a deal approved by the UK pensions regulator, the 3,300 pension scheme members of Halcrow, the engineering consultancy, have just received a letter giving them the choice of entering the Pension Protection Fund, the lifeboat for capsized company pension plans, or moving to a new scheme.

This is a Hobson's choice. Either way, members would get lower inflation-linked annual increases — in some cases no increases at all — cutting their overall pension value by 10-15 per cent.

If pension reductions are not made, Halcrow argues it would be forced into administration, jobs would be lost, and pension scheme members would enter the PPF anyway.

The Halcrow scheme had £785m of liabilities on an FRS17 accounting basis at the end of 2014 — £500m of assets and a £285m deficit. The buyout deficit, the figure used by insurers to cover future liabilities, is now around £600m, and the PPF deficit around £225m.

Like BHS and Tata Steel pensions, both on the front pages of the press, Halcrow calls into question whether the UK's system of pension regulation is fit for purpose.

Halcrow is an old, established engineering consultancy, responsible for many projects, including the Channel tunnel rail link, Toronto's Pearson airport (see photo above) and the Chongzun expressway in China; in 2012 the UK government appointed it to develop the High Speed 2 rail project. It was bought by CH2M, the US consultancy, in 2011 for £124m, from a trust owned on behalf of employees.

Although Halcrow had a large pension deficit in 2011, none of the sale proceeds were injected into the pension scheme. The new owner did agree to stand behind the agreed recovery plan and schedule of contributions.

The proposed pension restructuring, made via a "regulated apportionment agreement" is rare and only approved when the regulator considers it is inevitable that the sponsor would go bust otherwise. The regulator must also be satisfied that the pension scheme is treated fairly alongside other stakeholders, and that it will be better off than in administration, taking into account any recoveries from "connected" parties.

Although the regulator has given its approval for this to go ahead, the Halcrow Pensioners Association [1] may bring a legal challenge.

As part of the deal, it is reported that CH2M will inject £80m in cash and guarantee £50m of Halcrow's pension payment obligations.

Even after reducing liabilities through lower pension increases and the £80m cash injection, the FRS17 deficit would still be around £100m, which should be plugged through deficit contributions.

Halcrow's agreed deficit contributions must be at least £50m — the size of the parent guarantee — but it is not clear if it would make any payments over and above this. If future cash contributions were just £50m, then the deficit could only be plugged through investment outperformance gained via aggressive assets.

If the new deal does rely on investment outperformance then it is not a long-term solution. It just kicks the can down the road. In all likelihood the Halcrow pension scheme would go into the PPF at some point in the future, perhaps with an even bigger deficit than the current £225m.

And an earlier 2015 plan to cut Halcrow pension benefits – rejected by the High Court – certainly relied on investment outperformance to square the circle, *"based on a recovery period of around 18 years and an initial split of 50:50 return seeking assets and liability matched assets with de-risking to occur by 2043"*[2]

[1] http://halcrowpensioners.org.uk/

[2] http://www.bailii.org/ew/cases/EWHC/Ch/2015/3685.html

The regulator should disclose details of the agreed deficit contributions, and explain if the approved deal relies on aggressive investment strategies of “double or quits”, effectively underwritten by the PPF, to plug the deficit. And, if so, how this minimises the present value of likely PPF losses, paid for by other company pension schemes.

After it has completed its BHS inquiry, the UK parliament’s work and pensions select committee is holding a broader inquiry into pension regulation. Halcrow should certainly be on its agenda.

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