



making business sense

UK pension funds lose £98 billion in two months. The government's Doomsday machine for bankrupting UK plc starts to rumble...

Latest data from the UK Pension Protection Fund (PPF) estimates that in aggregate **UK defined benefit pension funds by end December 2008 had a combined deficit of £195 billion**. Their estimate for end November was £136 billion; for end October £97 billion. **In other words, UK pension schemes lost £98 billion in two months**. During 2008, the assets of the funds covered by the PPF fell from £873 billion to £765 billion and the liabilities rose from £862 billion to £960 billion. These calculations are estimates using market indices and are called the PPF7800 index.

cebr has warned for some time that the UK pensions system was a Doomsday machine waiting to bankrupt the entire corporate sector. The underlying problem is that companies have made promises to their pensioners that with low yields and difficult economic circumstances were always unlikely to be met. Meanwhile, badly conceived legislation to protect pensioners took control of pension funds from the companies who ultimately had to sponsor the schemes and handed them over to a range of 'worker representatives' and so-called 'independents', mainly lawyers and consultants who made a comfortable living out of the schemes. Neither the 'worker representatives' nor the so-called 'independents' had any very strong interest in protecting the companies, the ultimate sponsors, from the consequences of their bad investment decisions. Meanwhile, the PPF was to bail out the schemes where companies were bankrupted with their pension schemes in deficit by raising a levy on those companies that remained solvent.

Now the Doomsday machine has started to rumble. The fall in asset values plus the drop in yields on long dated stock have caused the enormous losses made by the funds in such a short period. **The result is that pension funds have lost more money in the past two months than Alastair Darling plans to borrow in the entire financial year** (£77.6 billion according to the Pre Budget Report), although it should be pointed out that Alastair Darling will borrow more than he plans to.

To put the numbers in perspective, we estimate that UK non financial companies made about £255 billion in gross operating surpluses in the 12 months to end December 2008 (government figures also show financial companies making surpluses of nearly £60 billion over this period but since the main banks virtually ran out of money we can take this data with a pinch of salt). Over the same period the pension fund position moved from a surplus of £12 billion to a deficit of £195 billion. **In other words the loss on the pension funds has wiped out 80% of UK non financial company profits for the past year**. It is quite likely that, since few pension funds produce real time valuation information, many finance directors do not yet realise this, let alone the stock markets...

Monthly pension fund valuations are volatile and it would be worth waiting a few months more to see what happens. But it is clear that many companies will not be able to afford to pay the losses made by their pension funds. But if the companies are bankrupted, the pension fund deficits will be crystallised and charged to the PPF. In turn the PPF will charge higher levies to the as yet non bankrupt companies who could well then be pushed themselves into bankruptcy. **The alternative will be politically unpopular but is the right thing to do – to force the recipients and potential recipients of defined benefit schemes to take a cut in their benefits to bring the funds back into solvency. Our rough and ready estimates are that if benefits were cut by 10% across the board and if companies were to pay up to cover the rest of the deficit a rolling collapse into bankruptcy for UK plc could be averted.**

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