

Distressed employers and defined benefit (DB) pension schemes

The ongoing COVID-19 crisis, and the use of lockdowns to limit the spread of the virus, means there is increasing fear that those employers who weathered the initial storm may yet struggle to survive and thrive through the winter and beyond. This pessimism may yet be exacerbated by Brexit which, at the time of writing, is due to come into full effect from the start of 2021.

The Pensions Regulator (TPR) has issued targeted guidance for trustees of distressed DB schemes, aimed at raising awareness and giving some useful tools and tips if their sponsoring employer is having financial difficulties.



BROADSTONE

GUIDE FOR TRUSTEES | DECEMBER 2020

Key points from TPR's guidance

Integrated risk management

All trustees should have adopted a fully documented integrated risk management (IRM) approach to their scheme, with workable contingency plans and suitable triggers in place. Practising IRM will help to highlight problems early on. The sooner trustees act, the greater the prospects of protecting the scheme's position and members' benefits.

Trustees should regularly review these risk management and governance procedures to make sure they remain fit for purpose.

Regular engagement

Engaging regularly with the sponsor and, where applicable, other creditors will help trustees to identify and manage key risks early on, allowing time to consider and implement appropriate actions to secure the scheme's interests. If contingent actions form part of the trustees' IRM framework, it is vital to be aware as soon as these are triggered.

TPR recommends agreeing an information sharing protocol between trustees and employers, including non-disclosure agreements concerning third parties, to foster trust and collaboration.

Do not delay

If trustees delay putting robust scheme protections in place, other stakeholders, such as lenders, will be in a better position to exert control over and extract value from a distressed sponsor, potentially to the detriment of the scheme.

Before any potentially detrimental transactions planned by the employer go ahead, the trustees should be permitted an opportunity to consider the effect on the scheme. This would include transactions that involved, for example:

- **refinancing or the injection of further company debt**
- **security granted to other creditors**
- **the sale of business assets**
- **a change of ownership of the sponsor**

Trustees will need to take expert professional advice to explore their mitigation options as soon as such transactions are under consideration.

Be alert to scams

Trustees should remain alert to pensions scams or unusual transfer activity and prepare a targeted communications strategy to support members when they are facing uncertainty.

Use Pension Protection Fund contingency planning guidance

If a sponsor is facing the prospect of insolvency, trustees should refer to the Pension Protection Fund (PPF)'s contingency planning guidance.

Broadstone comment

The key points set out by TPR have IRM in front and centre position; as it has been since the idea was first mooted in 2014. All trustees should be able to demonstrate they understand the nature of their sponsor's business, the risks to its continued viability, and those areas where value could be extracted. Trustees should also be prepared to monitor changes over time, with triggers and actions in place. All other items in the lengthy guidance flow from this starting point.

TPR's guidance is long and can be read here:

<https://www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/protecting-schemes-from-sponsoring-employer-distress>

However, as every scheme situation and dynamic is different, we have created a number of checklists for trustees to work through. These will help you determine how comfortable you are with your understanding of, and the risks posed to, the employer covenant provided by your sponsor.

Your Broadstone consultant or client relationship manager will be able to work through the checklists with you.

The checklists begin from a 'business as usual' phase - where trustees should be preparing themselves for potential covenant erosion, or at least assessing the robustness of their current position.

There are five separate checklists, each covering a key element of the process:

1. **Assess and understand your employer covenant**
2. **Manage actions should the sponsor request an easement**
3. **Help identify if the sponsor is in distress**
4. **Manage actions if the sponsor is in distress**
5. **Manage actions if the sponsor is likely to become insolvent**

The checklists are generic and are designed to be thought-provoking and prompt feasible action. You may, of course, need to tailor the checklists to be appropriate for your scheme's specific circumstances. It is worthwhile reading all the lists, especially when considering and planning what actions you may need to take under certain scenarios.

1. Assess and understand your employer covenant

Questions	Trustee response	Outcome / Actions
Legal obligation to the scheme		
Do you understand the sponsoring employer's legal obligation to the scheme?		
Have you considered the outcome for the scheme in the event of an insolvency?		
Are there ways to improve the insolvency outcome for the scheme?		
Is the sponsor part of a wider corporate structure?		
Do you understand the balance of powers between trustees and employer?		
Are there any obligations on the employer to share information with you?		
Has an information sharing protocol been agreed and introduced?		
Has the trustee considered any contingent-asset or asset-backed contributions?		
Is the scheme eligible for entry into the PPF?		
Is the sponsoring employer based overseas?		

Contingency plans		
Do you have a legally enforceable contingency plan with triggers for implementation?		
Have you reviewed the risk of funding and investments borne by the employer covenant?		
Governance/skills		
Do the current trustees have the skills and understanding to assess the employer covenant?		
Do you understand the current trustees' potential for conflicts of interest to arise, should the sponsor fall into distress?		
Do you keep good-quality records of meetings, decisions, actions and responsibilities?		
Covenant monitoring		
Are you provided with budgets and forecasts?		
Are these regularly reviewed and queried with the employer?		
Are debt levels and maturities understood?		
Do you understand movements in forecasts and budgets which give cause for concern?		
Do you need specialist covenant advice?		
Have you considered specialist employer covenant advice?		
If no, why not?		
If yes, what steps have you taken?		

2. Actions if sponsor requests easement

Questions	Trustee response	Outcome / Actions
Has the sponsor asked to reduce deficit recovery contributions?		
Has the sponsor requested a release of security?		
If yes:		
Do you understand the legal obligations of the sponsor?		
Are the trustees being treated equitably in relation to other stakeholders/creditors?		
Are other assets available as a contingent asset?		
If a release of security has been requested, have you considered professional legal and covenant advice?		

3. Identify if the sponsor is in distress *This list is not exhaustive...*

Risk metric	Identified (yes / no)	Action
Cashflow constraints		
Credit downgrades		
Removal of trade credit insurance		
Disposal of profitable business units		
Scheme-specific risks:		

4. Actions if sponsor is in distress

Questions	Trustee response	Outcome / Actions
Have you taken steps to increase monitoring?		
Review data being provided - is there more now needed? (e.g. short-term cashflow)		
Have you discussed what data is available/being prepared by management?		
Have you reviewed your contingency plan triggers?		
Should trustees meet more regularly?		
Do you understand other creditors' positions?		
Do you need advice from a restructuring specialist?		
Have you considered the scheme's value at risk (VaR)?		
Should hedging of inflation and interest rate risk increase?		

Questions	Trustee response	Outcome / Actions
Are transaction mandates with investment managers up-to-date, in the event that asset movements are required?		
Do you understand credit structures and debt maturity with the sponsor?		
Has the employer requested any non-disclosure agreements?		
Are you aware of or monitoring corporate transactions that may remove value from the business/reduce the value of a contingent asset?		
If yes, have you considered legal and professional advice?		
Has the sponsor suggested a CVA or RAA? If yes, these will require professional advice and clearance from TPR.		
Have you considered communicating with members to advise them of activity with the sponsor, the protections they have in the scheme, and to warn against scams?		
Are you monitoring transfer activity amongst the membership?		

5. Actions if sponsor is approaching insolvency

Questions	Trustee response	Outcome / Actions
Are you able to realise assets and charges contingent on the employer's failure?		
Are you able extract any relevant scheme data and documents held on site?		
Are there scheme functions performed by the sponsor that will need to be undertaken elsewhere?		
Have you reviewed investments for liquidity and de-risking?		
Have you assessed cashflow requirements for the ongoing payment of pensions?		
Are you able to report to TPR any notifiable events?		
Do you understand the next steps for entry to the PPF?		



BROADSTONE



broadstone.co.uk



[@broadstone_ltd](https://twitter.com/broadstone_ltd)



[broadstoneemployeebenefitsltd](https://www.linkedin.com/company/broadstoneemployeebenefitsltd)