

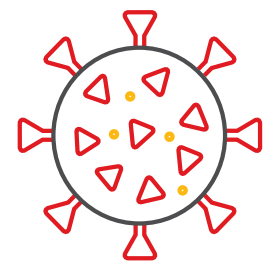
Challenges to employer covenant and cash management through the Covid-19 pandemic

Covid-19 is having a material negative impact on individuals, society, governments, businesses, financial markets and pension funds.








While the financial impact of Covid-19 is unquantifiable at present, from a covenant perspective we can see that many employers will likely suffer from reduced demand, e.g. airlines, travel, retail, leisure and employers in any sectors where spending is discretionary or can be postponed. Corporate and individuals' capital expenditure plans are also likely to suffer which will reduce demand further.

Therefore, surviving the next six to 12 months may be the goal for many employers, which means cost cutting where possible (jobs, capex, dividends, pension contributions, etc), potentially renegotiating banking covenants and seeking government support.

Defined benefit (DB) pension schemes can expect to be asked to take a share of the strain, which could create problems for trustees, many of whom have seen material reductions in their schemes' funding levels over the last few weeks. In other words, just when trustees most need an employer's support, the employer is least able to provide it!



Questions all trustee boards should be asking regardless of the employer's industry

-  What actions are being taken to conserve cash and improve cash flow?
-  Where dividends and share buybacks had previously been planned – have these changed?
-  What assistance is being sought from suppliers and other creditors?
-  What discussions are taking place with the company's lenders and what financial information (including revised forecasts) have been (or will be) made available to lenders?
-  Can the trustees have access to that same financial information?
-  What is the company doing to access available government support initiatives?
-  How often does the company intend to put together trading updates to aid discussions with stakeholders?

Action plan for trustees and sponsoring employers where available cash is severely constrained

In many cases, employers will need to use all levers at their disposal. If availability of cash is genuinely constrained, then keeping the company afloat could be better for member outcomes than continuing to pay pension contributions.

As a result, trustees and employers may need to consider a temporary reduction or suspension of pension contributions. The Pensions Regulator (TPR) recognises that trustees may need to agree very quickly to a short-term deferral of contributions with a more considered decision to be taken once better information is available.

It is possible for trustees and employers to agree to revise DB pension contributions between triennial actuarial valuations, taking appropriate actuarial and legal advice to avoid unintended consequences.

1.	Work together from an early stage	Raise potential difficulties early and provide further details as and when they are available.
2.	Engage with other key stakeholders	All parties have a role to play, including shareholders, lenders, suppliers, customers, landlords, government and regulators.
3.	Read latest TPR guidance	TPR's <u>guidance</u> tells trustees what TPR expects of them, and tells employers what to expect from trustees.
4.	Assess the current position	Understand what flexibility the employer has and the "pinch points" on cash flow and liquidity.
5.	Share information	Information sharing needs to be proportionate, focussing on the immediate term rather than trying to forecast beyond then.
6.	Be flexible, but protect members' interests	Ensure that the pension scheme is treated fairly relative to other stakeholders, but be realistic as to what is possible.
7.	Consider additional support	But be aware that there is likely to be limited scope for additional support to be provided to trustees or other stakeholders.
8.	Check scheme cashflow requirements	Suspending contributions may mean that scheme assets need to be sold – in illiquid markets – to meet members' benefits.
9.	Check trust deed and rules	Check for unintended consequences such as triggering s75 debts or scheme wind-ups.
10.	Agree an appropriate package	And agree how and when contributions will resume once affordability improves.
11.	Amend Schedule of Contributions (SOC)	Any new SOC must be certified by the Scheme Actuary, and amended recovery plans need to be submitted to TPR promptly.
12.	Keep talking to each other and to members	The position should be kept under review with ongoing exchanges of information.

If you are a trustee or employer and would like to know more about the actions you can take to navigate through the current challenges to pension schemes and employer covenants, please contact us.

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