Navigating sponsor distress: an action plan for trustees

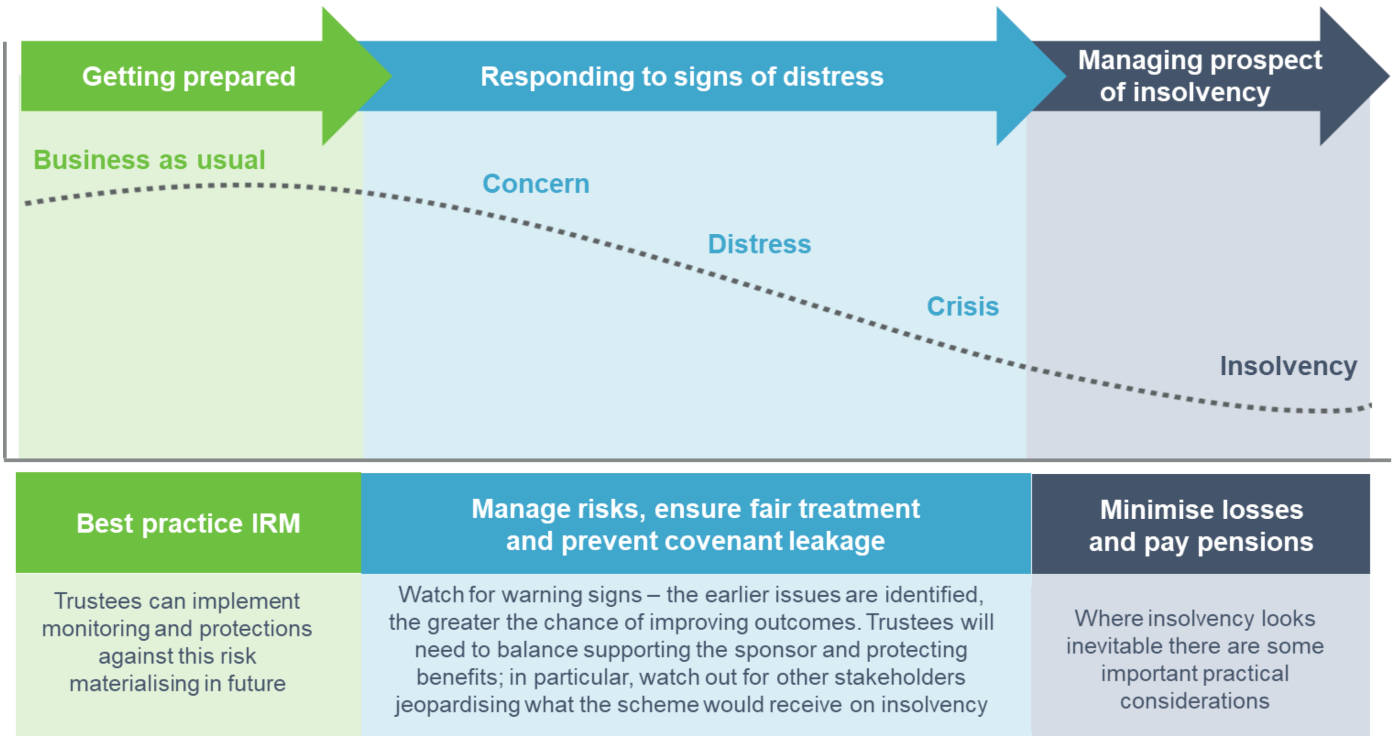
Background

Amidst the fallout from the coronavirus outbreak many companies are facing an uncertain future. Almost every day there are announcements of companies cutting jobs and it remains to be seen how effective policy responses will be in limiting insolvencies in the longer term. Whilst trustees should always be alive to the risk of sponsor distress or failure, it's clear this risk is currently heightened.

With this in mind, The Pensions Regulator (TPR) has recently refreshed its guidance for trustees on sponsor distress advocating early, decisive action to improve outcomes and reminding trustees of the need for appropriate monitoring and robust contingency plans. In difficult times, trustees should be particularly alert to other stakeholders seeking or enforcing security ahead of the scheme. Protect the scheme's creditor status, watch for signs of covenant leakage and ensure that the scheme is treated fairly relative to other stakeholders.

What can trustees do to protect the pension scheme?

Thinking through the practical steps you can take and the contingencies you could put in place is a good place to start. As a sponsor becomes more distressed, the available time and options to protect the scheme reduce.



Taking time to understand TPR's guidance and the potential implications for your scheme is a good first step towards building this into your plans. Use our checklists that follow to quickly assess your preparedness and develop an action plan.

Checklist of key IRM actions

1. Getting prepared

☐ **Agree information sharing protocols**

A legally enforceable information sharing protocol agreed with the sponsor will make sure everyone is clear on what needs to be shared and when. Look for information on factors such as trading, liquidity and forecasts.

☐ **Establish regular covenant monitoring**

Monitor the covenant on an ongoing basis. An IRM dashboard could be used to monitor key covenant, investment and funding risks against specific triggers to support decisions. Specialist covenant advice might help highlight emerging issues.

☐ **Manage conflicts**

Conflict management plans should be in place and confidentiality agreements will resolve any concerns about sharing sensitive information.

☐ **Confirm legal obligations**

Legal advice can help trustees look for ways to improve the position of the scheme if the sponsor were to become insolvent. Are the entities with an obligation to the scheme the ones with the assets? Legal recourse and enforceability are key.

☐ **Stress test scenarios and resilience**

Stress test potential covenant events, such as the loss of a major contract or adverse market conditions, alongside investment and funding risks to assess how exposed the scheme is and what actions could be improve outcomes.

☐ **Agree legally enforceable contingency plans**

Where possible, plans should be legally enforceable (with specific triggers). Look at whether contingent assets, guarantees or other protections may be available to mitigate against sponsor covenant weakening in future.

2. Responding to signs of distress

☐ **Increase frequency and depth of monitoring**

Things can change quickly and keeping channels of communication open between trustees and the sponsor is crucial in difficult times. Trustees will want to review and understand the sponsor's position and plans. Agreeing information sharing in advance ensures this isn't overlooked in times of stress.

☐ **Review trustee skills**

Ensure the trustee board has the necessary skills and experience and consider whether the circumstances create any new conflicts. It is possible that trustees and key staff such as the pensions manager may be made redundant. An independent trustee with restructuring experience could be a timely addition.

☐ **Take specialist covenant advice**

Specialist advice is advised given the added complexity and more in-depth investigation required. Other creditors will be completing analysis which you may be able to access. All advice and decisions should be documented and you may want to engage with TPR.

☐ **Revisit investment strategy**

Review investment strategy and re-assess supportable downside risk. Assets may need to be moved quickly if the covenant deteriorates; keep authorised signatory and delegated authority lists up to date and have a plan in place for electronic signing.

☐ **Ensure fair treatment if reducing contributions**

Although this could offer necessary short-term breathing space, trustees should make sure that shareholders and other creditors are also 'leaning in' proportionately, as well as seeking other forms of security to mitigate the extra risk.

☐ **Protect insolvency value**

Is there an estimate of the value that might flow to the scheme on insolvency? Refinancing or security being granted to another stakeholder could dilute this value. Watch out for lenders negotiating improvements in their position. It is unlikely that releasing any existing security would be in members' best interests in all but exceptional circumstances.

☐ **Secure a seat at the table for sales, restructuring or refinancing discussions**

Participate and influence. Represent scheme interests in any transactions including how sale proceeds will be shared out, and any changes in debt or scheme security. If appropriate, discuss consolidation options.

☐ **Implement covenant protections**

Understand when existing contingency plans would kick in. Even at this stage there may be options to improve outcomes, such as securing assets or getting a pledge that additional debt will not be secured over employer assets.

☐ **Communicate with members**

Press headlines may be concerning to scheme members. Whilst trustees won't want to alarm members, they should consider how best to communicate and offer reassurance if needed. A Q&A may help with responding to enquiries.

☐ **Increase pension scams warnings**

Watch for an increase in transfer requests. As members may be more vulnerable to scammers it's important to ensure appropriate warnings are being included in member communications.

☐ **Reduce transfer values**

Ask the scheme actuary to review the transfer value basis and review whether reductions for underfunding could be introduced or increased.

3. Managing the prospect of insolvency

☐ **De-risk investments**

Swift action to reduce risk and protect against further losses might be needed.

☐ **Manage liquidity**

Increase cash balances to ensure the scheme has sufficient liquid reserves and is not a forced seller of assets if contributions stop suddenly.

☐ **Ensure pensions can be paid**

Implement contingency plans where payroll and administration services are carried out in-house and access to critical data, documents and functions could be lost. Would the bank account and payroll information be available?

☐ **Engage with TPR**

Early engagement as well as complying with obligations to report any notifiable events.

☐ **Understand any wider restructuring plans**

A complex area including possible compromise solutions such as a regulated apportionment arrangement (RAA) or a company voluntary agreement (CVA) as well as provisions under the Corporate Insolvency and Governance Act.

☐ **Assess PPF coverage**

Is PPF funding above or below 100%? Understanding the extent to which benefits would be exposed post insolvency is likely to help with decision making and assessing insurance market or consolidation options.

☐ **Prepare for PPF assessment**

PPF assessment would start if and when an insolvency practitioner is appointed with member benefits reduced to PPF levels. Trustees should familiarise themselves with the PPF's contingency planning guidance to know what to expect. Developing a project plan will help ensure that the scheme is prepared.

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Range of protections for improving outcomes

As noted above, it's important to consider the range of actions and protections the pension scheme can use. We've set out some of the main options below.

Charge over assets	Fixed charge over a specific asset or debenture over all the assets of a sponsor.
Parent Company Guarantee	Promise of support from a financially stronger parent or group company
Escrow account	Holds funds which will be released to the scheme if the sponsor becomes insolvent or on other agreed trigger events
Contingent cash	Pre-determined payments in other circumstances such as disposals of businesses
Negative pledge	Commitment not to perform certain acts without scheme consent e.g. not to grant security to a third party
Surety bonds/Letter of credit	Bank or insurer provides a guarantee to the scheme for a fixed amount
Improving insolvency priority	For example, subordinating competing intercompany claims or making other group companies participating employers

Remember early warning and participation is key

The more distressed a sponsor becomes the less opportunity there is to improve outcomes, especially once other stakeholders are competing for value alongside the scheme. Early engagement improves the chance of the scheme being treated fairly. An ongoing sponsor is clearly valuable for a scheme however, careful consideration and judgement will be required to assess how much 'leaning in' is appropriate to support turnaround plans and how best to ensure that the scheme has fair protections in place.

Get in touch

Please contact your usual Hymans Robertson consultant if you would like any further information or to discuss next steps, or speak to one of our experts.

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