

# Funding valuations in the current climate: Corporate Action Plan

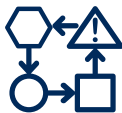
May 2020



Financial impact



Investment



Working with others

Companies with defined benefit scheme valuations this year are understandably going to be concerned about the cash commitments trustees may be seeking at a time when Covid-19 has put a strain on liquidity. Where funding positions have deteriorated and/or the company's covenant is assessed as having worsened, companies will need to be proactive with their scheme trustees to agree optimal and affordable funding arrangements, including use of alternative security packages where appropriate.

This action plan is intended to give a high-level overview of key areas for companies to consider as part of a current or upcoming funding valuation, in the context of the Pensions Regulator (TPR)'s 2020 [Annual Funding Statement](#) (AFS2020) as summarised in our recent [News Alert](#). Specific priorities for different companies will vary depending on circumstances.

## Financial impact

Area	Action
<b>Be proactive on funding valuations</b>	<ul style="list-style-type: none"> <li>Share your thoughts and principles on upcoming valuations with trustees at an early stage in the process. This includes proposals and rationale for the long-term funding targets (see below), the assumptions, recovery plans and affordability.</li> <li>Set clear objectives and priorities.</li> <li>Note AFS2020 gives no easements on the normal 15-month deadline for 2020 valuations and says trustees should only change a valuation date if it can be justified by improving member security. Propose optimal approach with this in mind.</li> </ul>
<b>Check you have quantified and are happy with the pension risk being taken (IRM)</b>	<ul style="list-style-type: none"> <li>Pension schemes can be a material financial risk for companies. In the light of the scheme's likely funding position, investment strategy, and company financial outlook, decide whether the company's approach to pension funding should change - for example, seeking to reduce risk in the pension scheme.</li> <li>Undertake "Integrated Risk Management" (IRM) analysis (eg scenario analysis) to understand the risks you're taking and the potential implications on eg future balance sheets and dividends.</li> </ul>
<b>Covenant and the impact of Covid-19</b>	<ul style="list-style-type: none"> <li>Consider the impact of Covid-19 and Brexit on your business from the perspective of the covenant to the pension scheme, to pre-empt trustee and TPR questions.</li> <li>Analyse where your covenant ranks in terms of TPR's bandings and determine your associated risks and expectations as set out in AFS2020. This is likely to strongly influence trustee and TPR thinking on assumptions and affordability.</li> <li>Watch our recent <a href="#">webinar</a> that considered how corporate sponsors are tackling the current pensions challenges, including covenant expectations, if relevant to your situation.</li> <li>Challenge whether information flows for covenant assessment are sufficient/onerous.</li> <li>Consider existing negative pledges, and scope / desirability of any new pledges.</li> <li>Understand implications of change of control, disposals or other corporate actions.</li> </ul>



## Financial impact (continued)

Area	Action
<b>Suspending DRCs</b>	<ul style="list-style-type: none"> <li>• Speak to trustees as early as possible if you will need to suspend or reduce Deficit Repair Contributions (DRCs), and include a robust business case for doing so.</li> <li>• Consider the implications of asking for a deferral of DRCs, eg trustees taking a more pessimistic view of covenant strength and potentially de-risking investments.</li> </ul>
<b>Long-term Funding Target (“LTFT”)</b>	<ul style="list-style-type: none"> <li>• Consider if helpful the appropriateness of any agreed / new LTFT – TPR encourages this to be agreed between the trustees and sponsor, and it is likely to become law in the next few years.</li> <li>• Be proactive – this may lead to a more favourable outcome.</li> <li>• Read TPR’s funding <a href="#">consultation</a>, and / or <a href="#">AFS2020</a> if you’d like further detail.</li> </ul>
<b>Assumptions</b>	<ul style="list-style-type: none"> <li>• The trustees will consider what assumptions might be appropriate to update in the light of changes since the previous valuation, and sponsors should agree what analysis to do and proactively share views on key assumptions and related points (for example covenant, investment returns, mortality and any impact of RPI reform).</li> <li>• Consider availability and desirability of offering additional financial support to trustees, to support less prudent assumptions.</li> <li>• Benchmark your assumptions against other schemes to assess relative prudence.</li> </ul>
<b>Recovery Plan</b>	<ul style="list-style-type: none"> <li>• Assess what modifications are needed to the current recovery plan to meet any updated deficit.</li> <li>• Work with the trustees to consider if <a href="#">alternative solutions</a> could be part of the valuation agreement. This could involve the use of Asset Backed Funding (ABF) structures, escrow, guarantees or other arrangements. Join our upcoming <a href="#">webinar</a> to learn more.</li> <li>• Consider pre-agreeing future contribution increases if certain covenant / funding triggers are hit.</li> <li>• Analyse the impact of allowing for post valuation experience (eg changes in financial conditions) when setting the recovery plan – TPR highlights this flexibility.</li> <li>• Consider when agreeing the recovery plan whether the scheme is being treated fairly compared with other stakeholders, checking against TPR’s expectations for this.</li> <li>• Assess any allowance for outperformance (as may not be allowed in future).</li> </ul>
<b>Other contributions</b>	<ul style="list-style-type: none"> <li>• Analyse impact of any trustee requests to allow for expenses in either the Technical Provisions or the ongoing contribution rate and consider alternative solutions.</li> <li>• Set out your preferred approach to setting an appropriate contribution towards any future service benefits – this could be more complicated if there are members who are furloughed.</li> </ul>
<b>TPR consultation (relevant for future valuations)</b>	<ul style="list-style-type: none"> <li>• Determine how your valuation stacks up against TPR’s likely Fast Track as set out in its consultation – our <a href="#">Fast Track Forecast</a> can help here. Although it is a consultation rather than guidance, it is indicative of how TPR thinks about funding good practice and how TPR (or your trustees) may assess the appropriateness of your valuation results.</li> <li>• If you do not satisfy expected Fast Track (or do not want to), consider if you will be able to justify your position under the “Bespoke” route, with contingent assets being one option to plug the gap. Our March 2020 <a href="#">webinar</a> gives an overview of what funding might look like under TPRs consultation, in a post Covid-19 world.</li> </ul>
<b>Buy-out / consolidation</b>	<ul style="list-style-type: none"> <li>• Understand your buy-out deficit, as this may be lower than you think, and you may be able to remove future risk from your balance sheet.</li> <li>• If buyout is not affordable, consider the merits of DB consolidators.</li> </ul>



# Investment

Area	Action
<b>Review &amp; test your investment strategy</b>	<ul style="list-style-type: none"><li>• Consider the level of investment risk taken now and into the future and whether this is still within tolerance levels for the company.</li><li>• Revisit what is the best estimate of investment returns now and into the future, to incorporate into the valuation discussions.</li><li>• Discuss and agree with the trustees how and when you plan to reach any long-term funding target, and how you plan to invest when you reach it.</li><li>• Consider the appropriateness of your longer-term investment strategy and the merits of different investment de-risking profiles over time.</li><li>• Make sure the maturity of the scheme has been properly reflected in the investment strategy.</li></ul>
<b>Near term threats &amp; opportunities</b>	<ul style="list-style-type: none"><li>• Ensure you are taking all necessary or appropriate short-term investment actions in light of Covid-19, Brexit and RPI reform. More detail is in our Covid-19 <a href="#">action plan</a>.</li><li>• In particular, test whether the level of interest rate and inflation hedging remains appropriate, whether to rebalance asset allocations, whether cashflows can continue to be met, and ensure opportunities are not missed.</li></ul>

## Working with others

Area	Action
<b>Trustee interaction</b>	<ul style="list-style-type: none"><li>• Develop clear lines of communication with the trustees – a collaborative approach usually leads to better outcomes.</li><li>• Help your trustees to understand the covenant impact of both Covid-19 and Brexit.</li><li>• Understand how trustees may view covenant leakage occurring (including dividends, inter-company loans, cash pooling, group trading arrangements, management fees, executive remuneration and other forms of value transfer).</li><li>• Consider appointing an independent trustee if additional experience would be helpful.</li><li>• Put in place / refresh confidentiality agreements.</li><li>• Check rules to ensure paying appropriate benefits eg on RPI versus CPI.</li></ul>
<b>Consider Board training</b>	<ul style="list-style-type: none"><li>• Consider any training requirements for the Board – the pensions landscape has changed a lot in three years so make sure management is up to speed on the implications of the <a href="#">Pension Schemes Bill</a>, what other companies are doing, the TPR's <a href="#">consultation</a> and the current <a href="#">Covid-19</a> environment.</li></ul>
<b>TPR</b>	<ul style="list-style-type: none"><li>• Consider how to best manage the relationship with TPR if you think they may get involved in your valuation.</li></ul>

## Want to find out more?

If you would like further information, please visit our [Corporate Consulting team](#) or contact the partner who normally advises you.



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