LCP INSIGHT CLARITY ADVICE

Navigating uncertain times: An action plan for trustees

Updated for The Pensions Regulator (TPR) latest guidance

27 March 2020

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The Covid-19 pandemic shows how unanticipated risks can throw even the best laid plans off track. The effects on DB Schemes will be very wide ranging.

All schemes will need to start by considering what contingency plans are in place to make sure their admin keeps on running and their members get paid.

Next, we recommend trustees work through a structured plan of actions that considers all angles, which is why we have put this document together.

Conditions remain volatile and you will want to ensure you have the most accurate information available. Online tools such as LCP Visualise can provide the latest funding position.

We suggest an immediate priority is to make sure your **Governance** structures are robust, not least to make sure you continue to pay members' benefits when due.

Covenant is then the next priority as this is an area where current events will have very significant impacts on the strength of many sponsoring employers.

Your view on covenant will then shape your approach on **Investment** and **Funding** issues. In addition there are a number of other considerations to work through in these areas.

We find ourselves in uncertain times where the situation will develop much further over coming weeks and months.

In all decisions, as ever, it is important to be proportionate, keep long term goals in mind and follow your processes – pension schemes by their nature are long-term.

For further details of what the implications could be for your scheme, please contact the partner who normally advises you.

Governance

Area	*Action*
Board operations	• Check that appropriate measures are in place to ensure trustee business continues efficiently, and that channels of communication are working effectively between all stakeholders including boards, investment committees, sponsoring employers, advisers, administrators, and asset managers. TPR emphasises the need to continue to document all decisions.
Adviser and asset manager capability	• Understand the business continuity plans of your advisers and asset managers (including any insurance policies) – ours can be found here: LCP business continuity plans - and critically of your administrators so that member service levels are optimised, given the circumstances. This approach is also in line with the Regulator's guidance.
Member communications	• Consider engaging with your members to provide reassurance that the trustees are taking appropriate steps to enable them to continue to manage the scheme effectively.
Sponsor engagement	• Discuss developments with the sponsor to understand the impact Covid-19 is having on its business operations and outlook. If the effect on funding and/or covenant has been significant, consider whether to seek additional support for the pension scheme – for example additional contingent support.

Covenant

Area	*Action*
Covenant assessment	• Pro-actively engage with your covenant adviser and sponsoring employer to understand how COVID-19 could impact upon the sponsor covenant and understand its business continuity and contingency plans (including how these may impact the day to day running of the scheme, eg change in personnel or redundancies). • Consider how affordability of future contributions may change if profit and cash-flow are adversely impacted. If there are material levels of covenant leakage such as dividends or inter-company loans, this may need to be challenged. TPR notes that intra-company payments for liquidity purposes may be allowable but unlikely to be in interests of members. If these are put forward by the employer, trustees should ask for reasons, and get clarity on recoverability. • Consider, particularly for challenged sponsors, whether monitoring sponsor liquidity and cash flows (and cash commitments), including in relation to upcoming loan maturity dates and associated banking covenants is now necessary. • For schemes where sponsor insolvency looks possible, the PPF's guide – Contingency planning for employer insolvency – has some useful actions.
Challenged Sponsor	• Consider whether implementing a contribution holiday could assist in supporting the employer through short term cash flow constraints and what further information and advice you need to be able to support such a request (eg in relation to wider business actions, such as payment of dividends). The Regulator has provided detailed guidance on assessing sponsor requests to reduce or suspend deficit contributions. • Consider what additional protections it may be appropriate to request in return to help support the scheme in the longer-term. • TPR says trustees should be open to a contribution holiday request of 3 months, and a review after this time. Monitoring should be put in place. Trustees should take actuarial and legal advice on the mechanism to enact this and the need to re-certify the schedule of contributions, this is to avoid unintended consequences around missed payments triggering events. • Urgently consider if any contingent assets can be provided to the scheme and what the trustees negotiating position is in this regard. TPR also comments that any requests from the sponsor to release existing security are unlikely to be in members' interests. • Consider whether pro-active engagement with the Pensions Regulator and the Pension Protection Fund may be required. • Assess whether exploring options like a consolidator vehicle may be appropriate.
Contingency plans	• Explore with the sponsor whether there are any viable contingency plans to provide an increased level of covenant support (eg parent company guarantee, escrow accounts, charge over assets, asset backed funding, letter of credit or surety bonds). • Consider what the triggers are for existing contingency plans to be implemented, and when action needs to be taken (eg credit rating downgrade, profit warning, breach of banking covenants, extraction of value from the sponsoring employer to support wider group, changes of control or directors etc).
Monitoring	• Make sure you have a proportionate monitoring framework of the sponsor covenant (especially for those sponsors in industries which are susceptible) and agree information sharing protocols and / or a notifiable event framework. The regulator notes it is important for sponsors to provide the trustees with the info they need in a timely manner, particularly to make an informed choice around any contribution holiday.

Covenant related issues should be one of your highest priorities. For many sponsors current events will throw open the question of whether the same level of sponsor support remains available to the scheme. Key actions include engage, understand, re-assess, and monitor.

Read more here

Investment

Area	Action
Rebalancing	• Consider rebalancing your investment strategy, typically this will mean away from gilts which may have become overweight and toward growth assets. There are several approaches to this: moving back to benchmark in one go, phasing over time, or "go half-way". You may have excess collateral available in the scheme's LDI portfolio, which could be rebalanced into other assets.
Risk	• If covenant strength has deteriorated, review whether the sponsor can continue to underwrite existing levels of investment risk. Consider whether more hedging should be implemented to reduce risk, target funding dates pushed out or other forms of contingent security be sought. • Consider whether to reduce reliance on the covenant over the longer term (eg by bringing forward the timeframe for being fully funded on a low-covenant dependency basis).
Hedging & Collateral	• Consider your collateral position. You may want to retain higher cash buffers given market volatility or put money to work now credit spreads are wider. • Review your liability hedging arrangements as financial assumptions (eg long-term discount rates and inflation expectations) may have changed significantly from when your hedging was put in place. Trustees may also wish to review currency hedging of overseas assets.
Liquidity & Cashflow	• Evaluate your liquidity and cashflow position – do you have access to enough liquidity to meet pension payments, meet collateral calls and fulfil any commitments to illiquid asset classes? • Consider transferring additional funds into the Trustee bank account to cover future payrolls, benefit payments and expenses if disinvestments become more difficult should signatories, administrators or investment managers become unavailable.
Asset Transfers	• Consider all planned asset transfers and implementations of other key strategy and risk management decisions, given the day-to-day level of market volatility and increased transaction costs (out of market risk is particularly heightened). • For planned transfers and cash calls in the short term, review the process and requirements around wet ink signatures, documentation and timelines to ensure this remains feasible with remote working.
Opportunities	• Evaluate with your adviser the best opportunities that have been (or will be) created by the market disruption, and any changes in their long-term return expectations going forward.
De-risking	• Consider how to continue with any planned de-risking steps, (eg whether to pause, slow-down, continue as normal or accelerate).
Mandate Performance	• Check your mandates are performing in line with expectations given conditions and get ahead of any calls for collateral or potential gating of funds. • Review the portfolio with your investment adviser for any concentrations of risk that might exist to individual sectors, issuers or counterparties. • Consider whether to pause making any further commitments to less liquid assets – review their attractiveness compared to other opportunities and widening of credit spreads in more liquid markets. • Consider the merits of bringing forward any planned sales of less liquid assets to better position your scheme at the front of any queues.
DC including AVCs	• Members with DC funds including AVCs may have seen significant volatility in their funds. Consider what communications might be appropriate. • Keep an eye on how the default investment strategy has done. This will be where most members are invested and will likely be experiencing negative returns. • Ask the your provider or consultant for updates on the risk and return profile of the strategies to understand what members will have experienced from being in the strategy. • Check that any 'lifestyling' has helped protect members closer to retirement. • Trustees should consider how individual members might react to recent market moves and communicate appropriately, being aware of scams.
Investment Governance	• Trustees may wish to review their investment governance arrangements to ensure they are able to take timely, informed decisions. For example, by using a sub-committee.

Funding and member options

Area	*Action*
Valuations	• If a valuation is in progress, consider how the position has changed since the effective date and, with any changes in covenant, the implications for the assumptions and any recovery plan. Consider whether to re-visit current negotiations. TPR has emphasised that trustees do not have to consider post valuation experience (apart from in the context that it might constrain affordability of the recovery plan) and don't necessarily have to revisit valuation assumptions. • Consider if any change in covenant is sufficient to merit revisiting existing funding assumptions or recovery plan agreements. • Engage with sponsoring employer to make them aware of the implications of market moves. Consider escrow or contingent funding to bridge funding gaps. • Read the regulator's latest guidance. You may be able to delay submitting a valuation due now by up to 3 months. • The Regulator's 2020 annual statement is now expected sometime after Easter and will include guidance for schemes currently undertaking valuations or with a valuation due soon.
Recovery plan	• Consider sponsor requests to reduce or suspend contributions in the light of the Regulator guidance. • Review the affordability of the current (or proposed) DRCs in light of impact of current events on sponsor's business
Insurance De-risking exercises	• Understand how market movements will have impacted insurer pricing. Widening credit spreads may make buy-in and buy-out pricing appear more attractive for schemes holding low risk assets. • Schemes already in a process should re-assess any value for money metrics, affordability constraints and investment considerations (such as impact on liquidity and leverage) to ensure the transaction remains appropriate. Consider whether any further due diligence is required, such as understanding the impact on insurer solvency positions and business continuity plans.
Transfer value terms	• Consider if current terms and approach remain appropriate, including reviewing the mark to market approach. • If you have a material fall in funding level, particularly if coupled with concerns about the sponsor covenant, you may want to consider cutting back transfer values or increasing any existing cut-back to protect the security of remaining members' benefits.
Transfer value quotations	• In the short term consider whether to suspend quotations to take stock. Once quoted, transfer values are typically guaranteed for 3 months. The Regulator states that it will not take action on trustees suspending transfer value activity for up to 3 months. • Increases in transfer values as a result of falling yields may make them more attractive to some members. Make sure your administrator is monitoring and reporting transfer value activity – quotations and payments – especially if there is an uptick in activity. This might have cashflow implications and/or prompt a further reassessment of terms or member communications, for example to strengthen warning of scams.
Other member option terms	• Check whether a review of other terms - such as the terms of exchange of pension for cash at retirement (commutation) and early and late retirement terms – would be appropriate. This may depend on the requirement of the scheme rules.
Bulk exercises	• if planning such an exercise (eg for transfer values or retirement options), consider terms carefully, given the uncertainties. Consider implications for the member advice process and timescales. If an exercise is underway, seek updates on engagement levels and understand the likely impact on funding and security.
Mortality assumptions	• Typical assumptions are based on data before the Coronavirus became a pandemic. Looking ahead, consider whether a change in assumptions would be material to your funding position or buy-out deficit.

Access Chart your own course, helping trustees to navigate their pensions journey here

At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy and financial wellbeing.