In Touch technical update

TPR guidance on protecting schemes from sponsoring employer distress

The Pensions Regulator (TPR) has published guidance for trustees of Defined Benefit schemes, entitled "Protecting schemes from sponsoring employer distress". In addition to specific actions where a sponsor is showing signs of financial distress or facing the prospect of insolvency, the guidance also outlines the steps all trustees of DB schemes should be taking, to ensure they are ready to act if this becomes necessary.

At a glance…

- Guidance aimed at trustees of all DB schemes, to ensure they are ready to act if this becomes necessary
- Additional actions where there are signs of financial distress or impending insolvency

Best practice

The guidance is intended to remind trustees of TPR's guiding principles of good practice and to offer practical recommendations for spotting signs of corporate distress. TPR notes that it is vital that trustees remain alert, prepare, plan and are ready to act.

TPR sets out the "Corporate stress curve" – emphasising the importance of identifying risks early, as the options to protect scheme members reduce over time, as a company heads towards insolvency.

Taking decisive action before a sponsor shows signs of distress increases the chances of mitigating risk in the future. With this in mind, TPR's guidance covers the following actions to be taken by all trustees:

- Understand legal obligations to the scheme.
- Ensure effective risk management processes are in place – documented and workable contingency plans to mitigate key risks.
- Review scheme governance – consider trustee skills and experience, potential conflicts on the trustee board, the need for clear documentation and record-keeping, and have an agreed information sharing protocol with the sponsor.

Why bring you this note?

The Pensions Regulator has published new guidance for the trustees of all DB schemes.

Next steps

Trustees of DB schemes should consider the guidance and the actions relevant in their specific circumstances.

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- Monitor the covenant to identify and mitigate sponsor risk – review and challenge financial forecasts and stress test assumptions; define what scenarios might result in concern or a covenant downgrade.
- Seek appropriate professional advice on the areas described above.

TPR also highlight the PPF's contingency planning guidance, and the following practical steps:

- Reviewing steps to realise charges and assets contingent on the employer's failure;
- Putting in place contingency plans for documents and data held on company premises;
- Review employers for PPF entry purposes;
- Putting in place contingency plans for payroll and banking independent of the employer;
- Making sure a complete set of governance documents is held.

Financial distress

TPR outlines specific actions to take where a sponsor is showing signs of financial distress:

- Know your sponsor's industry challenges – TPR outlines possible key warning signs and notes that other stakeholders are likely to seek to reduce their exposure to the business; early engagement can enhance the prospect of fair treatment.
- Increase the frequency of covenant monitoring – covenant strength can change quickly; it may be appropriate to shift focus to shorter term financial information.
- Perform a detailed review of the scheme's position in distressed scenarios – understand the returns to the scheme in a theoretical insolvency; understand the position of other creditors and inter-company trading and financing positions.
- Review your investment strategy – consider Value at Risk, what level of risk is supportable, hedging levels and contingency plans.
- Understand the role of other stakeholders – they may seek to reduce banking facilities, increase debt repayments or seek security on existing debt; changes to a scheme sponsor's capital structure should be reviewed.
- Consider requests for scheme easements – these may include deferring contributions or releasing scheme security; ensure you fully understand the scheme's legal position and obligations; engage in regular open discussions; TPR states it is very unlikely that security release will be in your members' best interests so it is important to obtain full legal and financial advice.
- Information sharing – the sponsor's board will be preparing focused trading information and closely reviewing liquidity; seek to understand what information is being produced and align information requests where possible.
- Transaction activity – corporate transactions can cause material detriment; TPR provides examples; trustees should seek mitigation.
- Communication with members – consider how to communicate with members, particularly if the financial difficulties are reported in the public domain.
- Be alert to scams and unusual transfer activity – actively monitor the number of requests for transfer values; if concerning patterns are identified contact FCA.

Facing insolvency

Where sponsor insolvency is looking likely, specialist advice should be taken before acting.

TPR notes that the Corporate Insolvency and Governance Act came into force on 26 June 2020, introducing new procedures for distressed companies, with a renewed focus on business rescue and survival. In some cases, this may lead to new risks and trustees should seek specialist advice to understand these.

If there are security structures in place, enforcement action may need to be taken and so trustees should ensure they know how to enforce such security.

TPR must be notified of some events by the trustees and of some others by employers.

Further guidance

There are four annexes providing further helpful information on: legal obligations to the scheme; warning signs of corporate distress; examples of specific cases; and a trustee checklist, to reduce scheme risk of sponsor distress.

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