First Briefing, March 2020 –
COVID-19: three months to take stock for DB trustees

The Pensions Regulator (TPR) has published further guidance on the impact of COVID-19 on DB pension schemes and their sponsoring employers[1].

The welcome news is that TPR is offering trustees time to take stock, by allowing the possibility of a three-month suspension (to 30 June 2020) of:

- employer funding contributions;
- transfer value quotes and payments, and
- submission of recovery plans for formal scheme valuations.

Nothing has changed in legislation in relation to these matters. TPR is just saying that trustees may not need to notify TPR of such breaches or that TPR will not take regulatory action.

When considering these options Trustees must
- consider the interests of members;
- take legal and actuarial advice (in real time if needed), and
- document the decisions they take.

Employer funding contributions

TPR suggests that *trustees should be open to requests to reduce or suspend Deficit Recovery Contributions (DRCs),* but that they should take legal and actuarial advice whether such a suspension or reduction is appropriate.

Where there is currently limited information on the impact of the COVID-19 pandemic on the employer, any temporary contribution suspension (or reduction) should be limited to a maximum of three months.

During this time the employer must provide ongoing, timely and relevant information, so that the trustees can monitor the employer covenant and make a fully informed decision about any longer suspension.

Suspensions (or reductions) should be shorter if trustees are not confident the employer can provide information on this basis.

Longer suspensions can be approved now, provided they are *fully considered* in line with TPR's March 2020 guidance[2] - i.e. with *full information on the business case* for doing so, and, *ideally, underwritten by any available protections*.

Trustees should consider carefully what to do if a substantial annual DRC or one-off payment falls due within the suspension period.

For schemes open to future accrual of benefits, a similar approach can be taken to suspending contributions for future accrual (employer or member), providing the scheme's rules allow it.

Fair treatment

Any suspension of employer contributions is subject to TPR's fair treatment principle – that distributions are not made to shareholders or owners, for example. This should be documented by the employer in a legally binding commitment.

Trustees should be satisfied that banks, other funders, and creditors of the employer are being similarly treated.

Intra-group transfers may only take place exceptionally, and where they are necessary to preserve the overall employer covenant, for example by preserving liquidity and going-concern status.

Finally, it is unlikely to be in members' interests that trustees release any security they hold over employer assets. Trustees should take specialist legal and financial advice if asked to do so.

Making good unpaid contributions

Suspended/reduced contributions should be made good within the length of the existing recovery plan, unless the existing one is short enough to extend without reducing covenant visibility (typically 5 years or less).

To update the SOC or not?

Trustees should take advice on how to suspend or reduce DRCs, typically either by amendment of the Schedule of Contributions (SOC), or a short-term suspension of payments without amendment to the SOC. This is to avoid unintended consequences such as accidentally triggering a scheme wind-up due to provisions in the scheme's rules.

Cash Equivalent Transfer Values (CETVs)

Trustees may, if they wish, suspend both the provision of new CETV quotes and the payment of existing ones.

New quotes

Failing to provide a CETV quote within the statutory period (three months and 10 days from the date the member request is received) remains a reportable breach of member disclosure requirements and statutory transfer legislation, but TPR will not take action in respect of such a breach.

Existing guaranteed quotes

Other than when a scheme enters wind-up, there is no statutory mechanism to allow a scheme to either reduce or refuse to pay a previously guaranteed CETV (assuming the member makes a valid request to complete the transfer within the three-month guarantee window). Nor can TPR approve any reduction or non-payment in this scenario. Members can, however, withdraw requests to transfer by doing so in writing,

Schemes would normally expect to complete transfers much sooner than the six-month deadline. There is already scope in the statutory timescales to delay payment of significant amounts. This might be to consider the impact on scheme cash flow, given that employer contributions may be suspended, and the priority should be to meet pensions in payment. This time could also be used to do extra due diligence on the destination of the transfer, and to confirm that the member wants to proceed.

Preparing to resume transfers

Trustees should use any hiatus to

- take advice on assumptions for calculating CETVs;
- take advice on whether to reduce CETVs, to reflect any underfunding ('insufficiency');
- assess the impact on administration of any increased demand for transfers, and
- assess the potential impact on cashflows and investments of paying CETVs already quoted.

Valuations in progress

Valuations with effective dates between 1 January and, say, 6 April 2019 will reach their 15-month deadline for completion over the next three months.

Assumptions will have been set, and liabilities and assets measured in market conditions much more favourable than those currently applying.

TPR will not require trustees to allow for relevant experience since the effective date of the valuation in their recovery plan.

TPR will, however, expect trustees to consider post-valuation experience when agreeing the recovery plan *in the context that the employer's affordability may now be constrained*.

Trustees can delay submitting valuations and supporting documents for a further three months, if they think it will be in the members' interests to take time to consider the scheme and employer's current situation.

"We are not authorising, encouraging or compelling a particular course of action - we expect trustees to do the right thing for their situation and members."

Investments and other matters

Trustees should consider the following matters and take appropriate advice.

Cashflows

- Expected payments from the scheme over the short to medium term and where they expect these to be met from, noting that suspended employer contributions and lower levels of investment income may reduce sources of cash;
- How expected scheme cash outflows and inflows might vary, for example, because of increased demand for retirement benefits or transfers; and
- Any investment strategy and investment mandate rebalancing requirements they currently have in place.

Risk assessment, management and governance

- Specific risks which may now exist within their portfolios or within their sponsoring employer's business - concentrations of risk and/or exposures to deteriorating sectors/credits;
- Previously agreed investment and risk management decisions due to be implemented in the future, including triggers in place. Do they remain appropriate and efficient? Might they introduce risks or crystallise losses?
- Investment governance structures and delegations. Can they continue to function and make decisions in the event of trustee incapacity or absence; and
- Whether they should make any changes to their investment and risk management governance framework.

TPR encourages trustees to *be mindful that market dislocations can also present opportunities* and *should consider with their advisers how they might evolve their investment strategies or arrangements at an appropriate time*.

DB guidance for employers

The guidance for employers is very brief and corresponds to the guidance for trustees around suspending or reducing contributions.

Employers should:

- justify any request to suspend or reduce DRCs;
- have a plan to make up deferred contributions;
- where possible, agree a plan to mitigate any detriment to the scheme, and
- treat the scheme fairly compared with other stakeholders - in particular, ceasing shareholder dividends.

Employers are also encouraged to document their position thoroughly.

Further information

If you have any questions, please contact your usual First Actuarial consultant.

References

[1] https://www.thepensionsregulator.gov.uk/en/covid-19-coronavirus-what-you-need-to-consider

[2] https://www.thepensionsregulator.gov.uk/en/covid-19-an-update-for-trustees-employers-and-administrators/guidance-for-db-scheme-trustees-whose-sponsoring-employers-are-in-corporate-distress