HYMANS ROBERTSON

Coronavirus (COVID-19): 5 actions to consider

The recent coronavirus outbreak has had a dramatic effect on financial markets with the potential to materially affect the covenant, funding and operational aspects of running a pension scheme. It is too early to know or assess the full consequences of the virus in full. However, it is critical that sponsors and trustees review their schemes' positions to understand the risks and how best to manage them.

At this stage, it's impossible to determine how coronavirus, and its impact on markets, will progress. Will things get worse before they get better?

The potential human impact is awful. First and foremost, our hope is that the spread of the virus will subside, and disruption will be minimised as far as possible. However, the recent spread of the coronavirus, particularly the increasing number of cases outside of China, means it is inevitable that this will materially impact the rate of global economic growth in 2020 and potentially beyond. The timing and shape of any rebound will depend on how quickly cases begin to peak, the containment measures deployed to slow the spread of the virus and the effectiveness of policy responses by governments and how quickly public sentiment is restored. We've seen how uncertainty and fear have caused significant market fluctuations over the last few days and weeks.

Against this backdrop, here are 5 key actions that trustees and sponsors should be taking now:

- ☐ **Understand the impact on scheme funding and agree a response to any material deterioration**

  With so much uncertainty we cannot predict what will prevail over the coming months. However, the spread of the coronavirus has already had a dramatic effect on financial markets. Risk assets have fallen significantly, particularly global equity markets. Conversely, safer assets have rallied, with government bond yields falling to historic lows, in part buoyed by emergency monetary policy actions. Against this backdrop many schemes are likely to have seen pension deficits increase.

  Regardless of where schemes are in their valuation cycle, there is value in considering the impact of recent moves, and potential future scenarios, to assess how exposed a scheme is and what actions could be taken to address any material deterioration. Trustees and sponsors who have developed contingency plans for exactly these kinds of scenarios should consider whether it is now necessary to take some of the actions they planned in advance.

  Careful reflection will be required for schemes part way through a valuation. Those due to sign plans off may need to consider whether a change in approach is required. Trustees and sponsors with 31 December 2019 and 31 March 2020 valuations may favour pausing until the outcome is clearer before locking in to a contribution agreement.

  When the dust settles, you could consider whether more scenario testing across a broader range of risks would add value.

On a potential longevity impact, there is much uncertainty. At this stage mortality rates are little more than approximations, given it's not clear how far the virus will spread and how many of those currently infected will survive. Ultimately the impact for pension schemes could be a reduction in their pensioner populations – which would have a direct impact on both scheme liabilities and cashflows.

- ☐ **Review sponsor covenant for adverse changes – impact will be different for every business**

Engage with your sponsor to understand the risks that coronavirus poses to covenant and the flexibility to provide additional funding support in the event it is needed. The impact will be very employer-specific depending on the nature of the industry; some industries will be hit harder than others.

Consider whether any further information needs to be requested and trustees who consider their sponsor or guarantor to be at particular risk may want to seek additional security.

- ☐ **Consider whether your investment strategy remains suitable, including managing the timing of any planned changes, triggers and ongoing liquidity**

Review the appropriateness of your investment strategy in the context of potential changes to covenant and the wider economic environment. Implementation of any planned investment strategy changes (or transitions currently underway) will need careful thought and phasing or deferring rebalancing until markets have calmed may also be sensible. Given the nature of pension obligations, trustees and sponsors should consider actions in the context of long term plans and associated costs. However, in certain circumstances if there are significant covenant issues, reducing risk and cutting losses could be appropriate.

Schemes should carefully manage liquidity, including reviewing where money is being disinvested from and whether to increase cash balances in schemes' bank accounts.

- ☐ **Review business continuity plans and manage implications for ongoing administration**

TPR's statement on COVID-19 referenced the expectation for trustees to have business continuity plans in place and to check the plans of their advisers and service providers.

Trustee boards should consider any delegation arrangements in case, for example, individual trustees are unavailable for a period due to illness. Temporary governance arrangements in relation to investment authorisations could be implemented. Meetings may need to be conducted over conference call and the board may wish to assess its travel dependency and ability to conduct online meetings (including arrangements for meeting packs). A business continuity plan should be drafted, and boards may wish to give greater consideration to robust succession planning, the appointment of a Deputy Chair, and detailed contact lists for board members, key advisers and their deputies.

Trustees should also be seeking reassurance from advisers and service providers of their ability to continue to support in the rapidly evolving landscape. This would include a situation whereby staff were required to isolate and work remotely or some staff became ill. Trustees will look for reassurance from third party administrators that critical tasks – such as paying pension payroll – will be prioritised. Trustees may also wish to take the opportunity to assess their digital communication capability, for example, the number of members easily contactable by email or text message, and the online self-service facilities available to the membership.

- ☐ **Have a strategy for communicating with members and consider impact on options such as transfer values**

  Given press headlines there may be some concern from scheme members, particularly pensioners. Whilst trustees won't want to alarm members unnecessarily they should have strategies in place to communicate and offer reassurance if needed, or have a Q&A ready for responding to enquiries.

  Low gilt yields could lead to an increase in the level and amount of transfer values (although real yields are down by less than nominal). Trustees should monitor this and consider any restrictions / modifications as necessary as well as ensuring they can meet any cashflow needs from a potential uptick. This might include asking the Scheme Actuary to review the transfer value basis and, where funding and covenant has deteriorated, whether reductions for underfunding could be introduced or increased. As members may be more vulnerable to scammers it remains important to ensure appropriate warnings are being factored into member communication.

With all this uncertainty we predict trustees and sponsors will find managing this a key challenge in the coming weeks. Taking time to understand the potential implications for your scheme using the checklist above is a good first step towards building this into your plans.

Please contact your usual Hymans Robertson consultant if you would like any further information or to discuss next steps.

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