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Covid-19: six actions for companies to consider

The Covid-19 outbreak has had a dramatic effect on corporate and consumer demand, and on financial markets. Pension scheme funding has deteriorated, and some companies are unable to continue existing pension contributions. The Pensions Regulator (TPR) has issued Covid-19 guidance for employers and trustees on 20 and 27 March. Companies should review their pension scheme position, engage early with their scheme trustees and document their position to help with any subsequent engagement from TPR.

It is clear that Covid-19 has had a very significant impact on corporates and financial markets. Against this backdrop, here are 6 key pension scheme actions for companies:

1) Request a funding update from your pension scheme trustees

This will help you understand the impact of recent market volatility on scheme funding and any required actions. Schemes with higher exposure to equities and credit, and lower levels of hedging, are likely to have seen the largest falls in funding levels, often of over 5%.

Downside funding triggers for paying additional contributions could have been hit, or be far more likely to bite at the next assessment date. Forthcoming triennial valuations are likely to show a higher deficit.

You should therefore engage with your trustees to understand their position. If you are unable to continue with the current level of pension contributions, it is particularly critical to engage as soon as possible.

2) Prepare a covenant update for your pension scheme trustees

Your pension scheme trustees will want to understand the impact of Covid-19 on the employer covenant, and the TPR guidance recommends that they initiate this assessment, and that you provide the required information. Ultimately the trustees will want to understand your contingency plans and your ability to carry on paying existing contributions.

We recommend engaging with your pension scheme trustees on the covenant impact of Covid-19 as soon as realistically possible. You will have more impact and influence over their assessment and subsequent actions if you are directly involved.

3) Consider requesting a suspension of pension contributions

TPR's guidance acknowledges that suspension of deficit reduction contributions is appropriate in some situations. This can be for up to 3 months as long as there are legally binding commitments that stop shareholder distributions for the same period of time. Longer term suspensions may be possible, but ideally with protections (e.g. security) and only when longer term covenant visibility is available. Any suspension should have a defined end date and triggers to restart if trading returns to normal. The missed contributions should be made good within the length of the existing recovery period.

4) Document your position

TPR's guidance recommends that you document your position with your DB scheme, as this will assist with any TPR engagement that may follow. We expect this is particularly relevant if you take any covenant deteriorating action (e.g. raising secured debt) or if you suspend pension contributions.

5) Contain costs

If you need to contain costs, ensure that your pension scheme trustees are also deferring non-essential costs. Core work like administration needs to continue, but suspending non-core work such as progressing GMP equalisation could be requested. Transfer values can also be suspended for 3 months under TPR's most recent guidance.

If your scheme remains open to accrual, consider ceasing accrual, although note it will around 3-6 months to complete a closure, and running a staff consultation at the moment may be challenging. More generally low yields and the treatment of open schemes under TPR's proposed new funding regime mean future service contribution rates are likely to increase at forthcoming triennial valuations.

6) Opportunistic transfer to a commercial consolidator

Commercial consolidators such as Clara-Pensions and the Pension SuperFund allow companies to discharge liabilities and wind-up pension schemes at a potentially lower cost than full insurance buy-out. These types of transactions may become more viable in the current environment.

Pension scheme trustees can only agree to a transfer to a commercial consolidator if it improves member security, and losing the existing covenant has been a block in some cases. However, Covid-19 will change this dynamic for some covenants, meaning commercial consolidator transactions may now be viable. It's likely that the Covid-19 situation will increase the political will for these transactions to happen, increasing the likelihood of transactions starting in Q2 2020.

If you would like to discuss these points in more detail, please speak to your usual Hymans Robertson consultant or get in touch with one of our experts:

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