

# Covid-19 and key actions for sponsors of DB schemes



The outbreak of Covid-19 and the resulting social distancing and self-isolation are unprecedented in recent times. This note discusses some of the issues that employers with defined benefit (DB) pension schemes should be considering now and actions you can take to support your business.

## Guidance from the Pensions Regulator

With regard to employers, the Regulator has:

- Stated that they recognise it is a challenging time and will take a proportionate approach to any enforcement decisions, with the aim to help employers get back on track<sup>1</sup>;
- Suspended all ongoing regulatory activity and events, in recognition of the unique circumstances; and
- Issued some guidance<sup>2</sup> for trustees of schemes with a sponsoring employer “in distress”. This does not rule out suspensions or reductions in employer deficit contributions and encourages trustees to consider any proposal from the employer carefully.

## Activity to date

Whilst the Regulator’s guidance is aimed at situations where the employer is “in distress”, we know that things can move quickly in the current circumstances and many employers will be looking to put in place actions that aim to prevent them becoming “in distress” in the next few months.

We are already aware of cases where employers and trustees are discussing temporary suspensions to deficit

contributions. An example of this is contributions due over the next few months being deferred until the end of the current recovery plan (and the recovery period therefore being extended by a few months).

We therefore think that all employers can credibly discuss the level of contributions with their trustees over the next few weeks.

## Deficit contributions

For many employers, DB deficit contributions can be a significant proportion of the cash generated by operating activities and/or cash reserves in general. These contributions are set out in the Schedule of Contributions and Recovery Plan agreed after each triennial valuation.

1 <https://www.thepensionsregulator.gov.uk/en/covid-19-an-update-for-trustees-employers-and-administrators>

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>

It is possible under the legislation to revise both a recovery plan and schedule of contributions without needing to go through a full valuation process. This flexibility is likely to be the starting point for most employers, but will need the trustees, and their actuarial adviser, to agree.

Note that existing Regulator guidance could be interpreted as saying that a delay of up to 90 days in contributions under the schedule of contributions is not material so long as it does not materially affect the funding of the scheme and there are no ongoing concerns over sponsor viability.

However, late payment of contributions may need to be reported to the Regulator and is likely to be less preferable than restructuring the recovery plan if time allows.

### Seeking trustee agreement to a delay in contributions

The Pensions Regulator advises trustees to consider a set of principles when considering a request to delay deficit contributions. Therefore, to initiate a discussion with the trustees, we suggest the employer prepares a proposal that covers the following areas:

1. The business case for the reduction or suspension of contributions that should include:
  - The pressures (including any effects observed already) on the demand for the employer's products and services and the impact on cashflow
  - The pressures (including any effects observed already) on the employer's supply chain and its ability to continue to provide products and services and the impact on cashflow
  - The details of the plan for reducing or suspending deficit contributions
  - The amount of the contribution reduction (partial or whole) and the length of time it applies for. We expect that the trustees will require a firm end date, rather than a set of conditions that must be met (when business is deemed as being "back to normal") before contributions recommence or return to previous levels. Trustees are

also being directed by the Regulator to require flexibility to be built into the plans so things can return to normal earlier than the end date if circumstances allow

- The employer's proposals for making good the missing contributions; for example by increasing contributions for the rest of the term of the recovery plan, lump sum payments etc.
  - Any additional security that can be offered to the trustee during the period of reduction or suspension
  - The proposed impact of the current uncertainty on other stakeholders (employees, shareholders, debt holders, lenders etc.) so the trustees can gain comfort that they are not the only party being asked to compromise
  - Any proposed impact on scheme expenses (see next section)
2. Details of the employer's Business Continuity Plan (BCP) and how the proposed contribution changes fit in to ensure the employer continues trading. We expect that trustees will be asking for detail of the BCP regardless of whether any contribution change is being proposed.

## Scheme expenses

The expenses of running the Scheme can also be significant and are paid directly by employers in many cases (not least because they can reclaim the VAT which the trustees cannot). Most schemes' rules contain a provision that the scheme can pay expenses directly (in which case they are paid indirectly by the company via its funding contributions).

Employers who are currently paying expenses directly should think about whether to agree with the trustees that the scheme pays these for a period of time, recognising the VAT issues, regardless of whether they are also discussing a suspension or reduction in deficit contributions. This can be extended to cover not just administration expenses but also the PPF Levy which is due to be invoiced in 2020 Q3 and which can be very significant for some employers.

Any proposal to move scheme expenses and levies to be paid by the scheme should be presented to the trustees in exactly the same way as described above for a contribution reduction or suspension.

## Transfer values

There are several issues with transfer values in the current circumstances:

- Members who are in financial hardship as a result of Covid-19 may find taking a transfer value attractive to give them flexible access to their pension assets. As mentioned in our recent DB transfer research<sup>3</sup>, members may find it hard to find a reputable IFA to advise them on the transfer. Pension scammers will also, no doubt, be looking to take advantage of the current circumstances to target vulnerable and unwary DB scheme members
- Given the falls in funding levels of most schemes, it may be necessary to reduce transfer values below their current levels
- Paying out transfer values reduces the scheme's liquidity and may necessitate disinvestment of assets in unfavourable market conditions to pay pensions

Employers should therefore discuss transfer values with their trustees to agree a way to mitigate these risks.

## Business continuity plans and trustees

Business risk focuses on the effect of uncertainty on objectives when conducting "normal" business activities. There has been now been a shift in the risk landscape with Covid-19, and previously identified risks may have been superseded by new ones that reflect the current state of response we are experiencing, as well as the "new normal" into which we are heading.

Regulator guidance advises trustees to assess that current business continuity plans (BCPs) are operationally effective and not likely to imperil member's benefits in the short-term. This includes both specific consideration of activities the sponsor undertakes on behalf of the pension scheme and more general consideration of the sponsoring employer's BCP. With regard to direct scheme/trustee support this might include payment of pensioners, access to HR data or secretarial support all of which could be compromised if key staff are unavailable or unable to access systems.

Through our pensions management, pensions administration and experienced Risk Advisory and Analytics business area we can support you in addressing these issues, putting in place contingency plans or simply responding to any trustee requests for further information.

Longer-term, this could lead to a review of existing business continuity measures to see if they can be improved. Specifically, trustees may look for improvements in the following areas depending on the extent to which they feel any existing business continuity measures are insufficient:

- Defining the procedure for communication between the business and the scheme during a crisis
- Confirming what information, assumptions and worse case scenarios both the business and the scheme should be working from; for analysis, planning and decision making
- Facilitating horizon scanning for risks that impact both the scheme and the employer (e.g. in-house payroll functions)
- Providing assurance reports on controls effectiveness and risk response actions
- Sharing business continuity plans, and agreeing minimum standards with improvement actions

We can assist in any of these areas.

### **Business continuity plans for your business**

More broadly than the pension scheme, with unprecedented triggers such as mass working from home, travel restrictions and closures of business premises; risks in many areas may now exceed appetite and tolerance thresholds; meaning existing controls may be insufficient or obsolete.

We can help you to build a resilient business ready for the new normal, and to give assurance to all stakeholders, including trustees, by:

- Optimising the risk process and protocols to compliment the current state of working
- Conducting risk identification across the business to unveil the new risks the business faces

- Assessing new and remaining business risks in light of new triggers, context and objectives
- Re-calibrating risk appetite and tolerance thresholds to prioritise the scarcer resources for risk response
- Reviewing risk governance and control frameworks for enhancing oversight and stakeholder assurance
- Continuously updating risk tools, reports and paperwork

To better understand the new and updated business risks, we suggest deep dives on principal risks, including but not limited to:

- Completing comprehensive supply chain risk assessments with critical suppliers, including review of Business Continuity Plans
- Conducting, employee engagement assessments
- Facilitating risk self-assessments with home-working in mind, as the potential for increasing risk coming from cyber, wellbeing, data breach and internal fraud

## What you can do now

Our specialist Employer Consulting team can help you devise a well thought through and reasonable proposal to the trustees for a reduction or suspension in deficit contributions (together with moving payment of running costs and levies to the scheme if appropriate). We can cover all aspects:

- Working with your finance team to understand your cashflow projections and how these can impact on the scheme
- Calculating the actuarial impact and structure of the change in contributions before and after the agreed period
- Helping you draft the proposal to the trustee and discussing it with them with a view to agreeing it
- Support you in your discussion with the trustees regarding transfer values. We can help you put in place a support framework<sup>4</sup> for the scheme members so that they can make a well-informed decision backed by sound advice on whether to transfer or not

- Working with you and your risk function to quantify business risk and appetite thresholds, and prioritising resource allocation and risk response actions
- Reviewing business continuity, risk governance and control frameworks against international standards, good practice and regulatory requirements
- Providing experienced interim risk professionals to support your risk function, or non-executive members to your Risk and Audit Committee for third party challenge and expertise

4 <https://www.barnett-waddingham.co.uk/comment-insight/research/db-to-dc-transfers-supporting-members/>

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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