

Understanding employer covenant in volatile economic times

Key topics to consider

Employers are currently managing a plethora of economic headwinds. As a sign of the times, The Pensions Regulator's 2022 Annual Funding Statement takes over 10 paragraphs to set these out and encourages trustees to speak to their sponsoring employer to understand how they are being impacted.

We set out below some exploratory questions that trustees can use to open a discussion with their sponsoring employer.

The challenges that companies are dealing with include the impact of:

- high inflation and inflation uncertainty;
- possible future interest rate rises on borrowing costs;
- energy costs;
- the war in Ukraine;
- the implementation of the withdrawal from the European Union (Brexit); and
- the COVID-19 pandemic – both on the workforce and following the removal of government support.

In all cases it is best to have an open dialogue between trustees and employers so that trustees can understand how the business and employer covenant are being impacted, and the actions that management are taking. The following questions are provided to help start that dialogue.

There will be overlap between the areas covered (for example rising inflation, the impact of the war in Ukraine on supply and energy costs) and it is likely that management will be taking several actions which manage a number of the areas at the same time (for example sourcing of supplies).

1. Business performance and plans



- How have recent economic events impacted on performance?
- What recent updates have been made to the business plan?
- What downside scenarios has the business assessed in light of current economic conditions?
- What actions, if any, is management taking as a result?
- What information is management producing regularly to monitor performance which can be shared with the trustees?

2. Inflation



- How is inflation affecting business running costs?
- Is the business able to pass on the impact of inflation to its customers?
- How is inflation expected to impact customer demand for goods and services, e.g. through reduction in disposable income?
- What actions are being taken to manage the impact of rising input costs?

3. Interest rates



- Is the business being impacted by rising financing costs?
- Does the business have sufficient financing and contingencies to manage any downside scenarios?
- Does any debt need to be refinanced in the short term?

4. Energy costs



- How is the business being impacted by rising energy costs?
- What actions are being taken to manage the impact of rising energy costs?

5. War in Ukraine



- Are any supplies or products sourced from Russia and Ukraine?
- Have sanctions impacted any key suppliers, customers, or areas of operation?
- Are there other countries where management is reviewing its business operations because of potential future fallout from the war?

6. Brexit



- Has the business lost any key customers or access to markets due to Brexit?
- Has the business lost access to labour or key expertise?

7. COVID-19

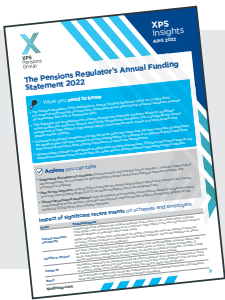


- Has the workforce been materially affected by COVID-19?
- Have any changes to business operations and workforce been required following the removal of government support?
- Does the business have any government COVID-19 emergency loans that it is repaying?

8. Broader questions that may be relevant



- How has the business been affected by current constraints on global supply?
- How has the business been affected by capacity constraints on freight and transport?



Find out more

For more information, please read our **XPS Insight on the Annual Funding Statement** [here](#). The full **Annual Funding Statement** can be read [here](#).

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For further information, please get in touch with **Elen Watson** or speak to your usual XPS contact.



 0113 518 7431

 elen.watson@xpsgroup.com

 @xpsgroup

 [xpspensionsgroup](https://www.linkedin.com/company/xpspensionsgroup)