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XPS Express for Employers

Bringing you the latest pensions news for employers

Covenant actions for employers during current funding valuations



At a glance

The Pensions Regulator (TPR) recently set out its expectations for current funding valuations

TPR does not typically expect deficit contributions to be reduced or recovery plans extended. Trustees are urged to understand how the pandemic and current economic conditions have affected their scheme's sponsor

Demonstrating your covenant and cash affordability will be important to ensure company contributions are appropriate for your business plans

Sharing your financial projections, business plans and scenario analyses can help trustees quickly assess affordability and make appropriate informed decisions

Employers could consider offering contingent assets or contingent contributions to reduce cash funding

Employers also need to be aware of new TPR powers and assess the impact of business changes or restructuring activity on their pension scheme



Key covenant areas for current valuations

Area	TPR view
COVID-19	<ul style="list-style-type: none">Reflect how the pandemic has impacted employers.
Brexit	<ul style="list-style-type: none">Distinguish short term impact from fundamental impacts on the business.
Cash	<ul style="list-style-type: none">Economic conditions and tax changes may drive changes in cash funding.Schemes should be treated fairly with other stakeholders.Use contingent support where needed to mitigate less cash.
Transactions	<ul style="list-style-type: none">Some businesses may restructure in light of circumstances and this should be reflected.



TPR's expectations depend on the impact of the pandemic on you as employer

COVID-19 impact	Key expectations
Limited	Maintain cash funding or reduce funding period.
Some but recovering	Reflect impact in funding plans.
Material and recovery is uncertain	Protect scheme relative to other creditors.



Actions employers can take

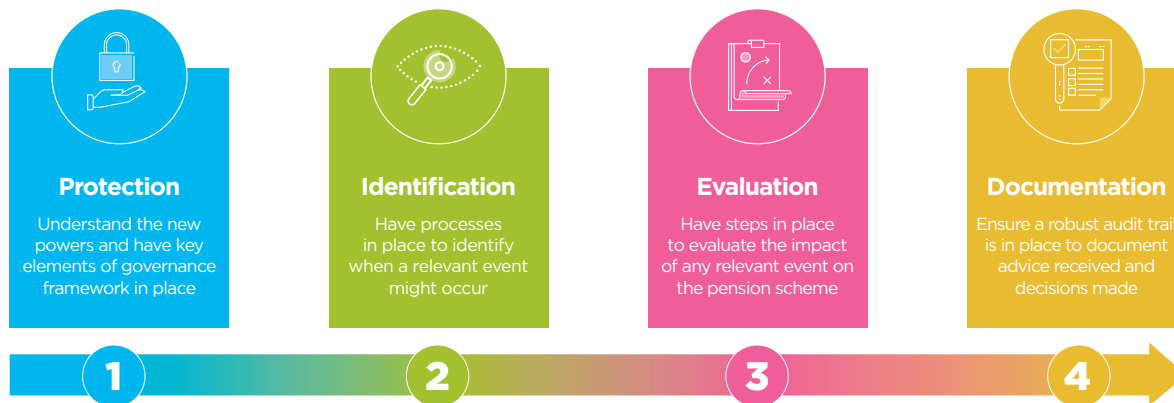
1. Engage early with the trustees and maintain an ongoing dialogue during the valuation process. Share details of corporate transactions as early as is practicably possible.
2. Consider what financial information can be readily shared with the trustees to help them understand the business without the need to undertake significant additional work.
3. Consider what level of contributions are reasonably affordable given your business needs. Document the factors influencing affordability.
4. Investigate whether there are feasible alternatives to cash contributions such as contingent support.



Using covenant analysis to control risk from TPR's new powers

New moral hazard powers and criminal and civil sanctions are expected to be in force from Autumn 2021. While these are not intended to change commercial norms, a number of companies are reviewing their internal controls to identify and respond to events that may be caught by these powers.

Four key parts of internal controls



Evaluation: covenant analysis can help build defences against future investigation

Defences are allowed against the new powers. The key components of each defence differ between moral hazard powers and new criminal sanctions. For each, a before and after analysis of the impact on the pension scheme is key – importantly, an analysis of how covenant and employer support has been impacted.

A Elements of a statutory defence against moral hazard powers

- **Due consideration** was given before the event to confirm whether the event could cause **material detriment** to members receiving their benefits; and
- If there was a **potential detriment**, **reasonable steps** were taken to eliminate or minimise the detriment; or
- You could **reasonably conclude** that the event was **not materially detrimental**.

B Elements of a reasonable excuse against use of criminal sanctions

- **Any detrimental impact** of an action or inaction was an **incidental consequence** – not a fundamental necessary step; and
- **Any viable alternative route** which would have avoided or reduced the detrimental impact was considered; and
- Any detrimental impact was **adequately mitigated**.

For further information, please get in touch with **Jim Heal** or **Paula Haughton** or speak to your usual XPS Pensions contact.



t 01483 330 119

e jim.heal@xpsgroup.com



t 0161 393 6863

e paula.haughton@xpsgroup.com



@xpsgroup



xpensionsgroup



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