



## corporate | monitoring of employers' covenants

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Earlier this year the Pensions Regulator ("TPR") published a consultation document to help pension scheme Trustees monitor their employers' support. This was as a follow up to its June 2009 statement which outlined how the covenant assessment can feed through to the setting of technical provisions and Recovery Plans. Detailed guidance has now been published following the period of consultation.

TPR has stated that:

"Monitoring the covenant can be as important as monitoring investment performance".

It is common for investment performance to feature as a staple agenda item on virtually every Trustee meeting agenda. Reviewing the covenant is far less common and often only features on a cyclical basis, for example, as part of agreeing a triennial Recovery Plan.

The latest guidance provides more information about what Trustees could do to measure and monitor the covenant and outline actions that could be taken to strengthen the security of a scheme should the need arise.

Trustees have a duty to ensure the security of their scheme members' benefits. Part of this process is a continued reliance on the support of the sponsoring employer. The Regulator notes that it is in the best interests of all parties for there to be an open and co-operative relationship between the employer and the Trustees. Employers should be willing to provide Trustees with the information they or their professional advisors reasonably require to assess and monitor the covenant.

In essence, the Trustees need to understand both the legal obligations of the employer and understand from a financial perspective its ability to meet those obligations.

In the latter respect, Trustees need to adopt a more commercial approach to their covenant review. In particular, an examination of trends analysis.

Covenant reviews are often carried out at a "point in time" e.g. for the purpose of agreeing an affordable Recovery Plan, then may well not be revisited until the next valuation comes round. Scheme members' security would, in many cases, benefit from a more regular examination of a series of key performance indicators such as cash flows, business risks and the employer's own covenant position. This would assist in ensuring that scheme Trustees remain up to date as to whether they are on course in meeting the scheme's statutory funding objective, or whether they could be faced with a nasty surprise when negotiations commence to agree the next Recovery Plan.

This approach is dependent on having consistent and good quality information available from the sponsor, and high quality interpretation of it.

Trustees should bear in mind the need to analyse what is appropriate for their pension scheme. For example, if profitability is sound and the sponsor's cash flow and asset base remain high, it would be unlikely that a detailed examination of the current order book would add value to the exercise. In this case a longer term view of the sponsor's strategy might be more appropriate. It is generally also important to bear in mind when planning the exercise that both short and long term market assessments should be considered.

haysmacintyre is willing to assist Trustees in exploring ways to increase the regularity and effectiveness of covenant monitoring. The team at haysmacintyre can do this either as a bespoke exercise, or in conjunction with our existing annual pension scheme audit work.

Please contact your engagement partner for a free initial consultation.

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