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High-wire skills required



Restructuring and Recovery
Real people, real solutions

As the economic climate darkens, pension fund trustees are finding it increasingly difficult to balance the rights of their members against the survival of their employers, say Guy Mander and Rhonda Gilmore

The dramatic events on the world's financial markets and the fear of worldwide recession have undoubtedly made life more stressful for pension fund trustees. With most pension funds heavily exposed to equities and property, the significant decline in the value of these investments has led to a sharp increase in fund deficiencies.

This has led to a dilemma for trustees. On the one hand, they have a fiduciary duty to safeguard the interests of their members by seeking funds from their sponsoring employer to shore up their schemes. On the other, demands by them for significant levels of cash have the potential to sink companies already struggling under the twin impact of the credit crunch and the economic slowdown.

Pension funds are generally unsecured creditors and therefore rank behind secured creditors in insolvency, so the long-term nature of the pension relationship means it is usually in a pension fund's best interest for its employer to survive and prosper.

Well before the current crisis, the Pensions Regulator introduced provisions for trustees to assess and monitor the strength of their employer covenant as part of their scheme-specific funding valuation process. While many trustees sought independent reviews to assist them in this process, others relied (quite rightly in many cases) on the financial prowess of the trustee group to carry out the assessment in-house. In many cases, this work was based solely on information in the public domain, such as historical financial statements and credit ratings.

Covenant assessments should be more frequent

The unprecedented upheaval in financial markets has prompted trustees who previously favoured the in-house approach to commission external experts to provide a more detailed – and



independent – covenant assessment. In addition to being good governance, it can also assist trustees in meeting the deluge of responsibilities and risks following the implementation of statutory regulation.

Financial market woes have also encouraged trustees who have already commissioned independent advice to review and update their monitoring plans.

Health checks are also becoming more frequent. Before the financial crisis, many of those trustees were assessing the sponsor's strength only as part of the triennial valuation or as part of M&A activity.

In recent weeks, Baker Tilly has been asked to update assessments for current trustee clients and also undertake numerous assignments for new trustee clients who have to date reviewed matters "in-house".

Without fresh and reliable information on the profitability, free cash and the solvency of their employer, trustees aren't in a position to make informed decisions about what their employer can realistically afford to pay.

Baker Tilly is advising its clients to ask searching questions during discussions with their sponsoring employer. In particular, they want to know whether the employer has considered the current financial market issues and the potential impact of a global recession on:

- the market in which the employer operates
- trading, profit and cash flow forecasts for the current year (and beyond). Have forecasts been revised and/or tested using appropriate sensitivity analysis?
- its funding facilities - ie whether banking covenants have been breached or are in danger of being breached.

Armed with this information, Baker Tilly can provide a prompt and independent assessment of the strength (or weakness) of the sponsoring employer. We can also help to negotiate with the employer on behalf of the trustees.

For example, if free cash is limited, Baker Tilly can advise trustees on relevant mitigation strategies. These include asking for

guarantees from the sponsor's parent company to fund any deficit, or negotiating "back-end loaded" recovery plans whereby the employer pays less now and more in later years. Indeed, in a worst case scenario, the assessment will help trustees decide whether entry into the Pension Protection Fund is a better option for their members.

Greater communication and common purpose

Wherever possible, the covenant assessment process should develop and enhance the relationship between the trustees and the employer. Greater understanding between the two parties is in the best interests of all stakeholders because in most cases corporate survival can only benefit the scheme.

Now is the time to introduce independent objectivity to the covenant assessment process. Trustees owe it to their members and, until the economy recovers, to the company on which their retirement depends.

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