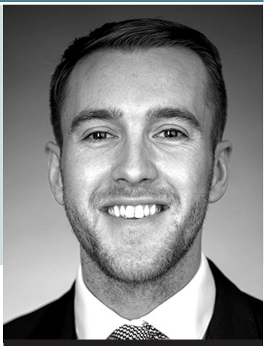
Preparing for possible sponsor distress


Liam Goulding, Sackers

Liam Goulding is an associate with Sackers in London who advises pension scheme trustees, employers and pension providers. Here he provides some advice for sponsors on how to deal with restructurings and the pension regulators.

Sponsoring employers have been facing unprecedented challenges in recent years, and this year in particular as a result of COVID-19. With recent high-profile cases of sponsor insolvencies, trustees will need to scrutinise employers more closely than ever, in order to assess the covenant strength and the risks of any covenant leakage.

> Given the speed at which distressed employer scenarios can unfold, it is important that trustees take steps to prepare now, and the UK's Pensions Regulator (TPR) has recently published guidance urging trustees of defined benefit schemes to be prepared for the possibility of their sponsoring employer experiencing financial difficulties.

Being prepared

Taking decisive action before a sponsor shows signs of distress increases the chances of minimising downside risk in the future. Trustees must therefore prepare to spot the warning signs of employer distress or insolvency.

Where possible, trustees should work with their sponsoring employers to agree a mechanism by which the employer will notify them of potentially material financial events (such as the issuance of new debt, granting of legal charges or other security, as well as any planned business acquisitions or disposals).

Trustees should consider current arrangements and whether any governance or risk management arrangements should be amended to understand the employer's legal obligations to the scheme, or to put in place or update crisis management plans and information sharing protocols.

Trustees should have processes in place (including lining up relevant advisers) to monitor the strength of their sponsoring employer's business and ensure that they have access to all relevant employer information, such as cash flow analysis, details of loan facilities and management accounts. Trustees should review and challenge such information and stress test assumptions as a part of the monitoring process.

Sponsor in distress

Where financial distress is apparent, trustees should be taking professional advice to make sure that all options to protect the scheme's position have been explored. Trustees should consider and be open to an employer's turnaround plans where these appear achievable but must also ensure that such plans are in the best interests of scheme members.

1 Suspension or reduction of deficit repair contributions (DRCs)

When faced with financial distress, a sponsor may seek various easements from the scheme as part of a wider restructuring process. Should the sponsor seek concessions from the scheme, such as a deferral of DRCs, the trustees should take advice.

In brief, trustees should be satisfied that the scheme is being treated fairly in comparison with other stakeholders and creditors and should look to other forms of security to help mitigate risk.

Trustees should be provided with sufficient information to make a fully informed decision and should undertake due diligence on the employer's financial position before agreeing a new suspension or reduction of DRCs.

2 Impact of corporate activity

Corporate distress can trigger corporate transactions. When considering a corporate transaction, trustees should review the impact on the sponsor's ability to continue paying scheme contributions, as well as the impact on the scheme's likely recovery in an insolvency scenario.

A corporate restructuring could have a detrimental effect on members' benefits where it results in the employer being less well equipped to meet its scheme funding obligations. It is therefore important for trustees to consider and understand what is being proposed and why, as well as what impact this may have on the scheme. Where possible, trustees should seek mitigation, albeit the chances of obtaining this may be limited in a distressed situation.

Both employers and trustees will be keen to avoid triggering TPR's anti-avoidance powers, including the new criminal and civil sanctions coming down the track under the Pension Schemes Bill.

Seeking clearance in advance for transactions in scope should help alleviate concerns here. In addition, where insolvency is inevitable, opening an early dialogue with TPR and the Pension Protection Fund will be crucial.

3 Restructuring plans for employers in financial difficulty

The Corporate Insolvency and Governance Act 2020 introduces two new options for companies in financial difficulties – a free-standing moratorium (similar to the one afforded employers in administration) and a restructuring plan. Both are intended to enable a corporate rescue (which could, ultimately, benefit a related defined benefit scheme).

While the Act sets out a renewed focus on business rescue and survival, which may be beneficial for schemes that are reliant on long-term employer support, there are potential new risks that will need to be taken on board. Trustees must ensure they understand the potential ramifications of these changes for their scheme and should seek professional advice in this scenario.

> Ultimately, the sooner trustees act and engage with distressed employers, the more options they are likely to have. Taking some preparatory steps now should help ensure that trustees are better placed to deal with such a situation, should it arise.