

The Actuarial Profession
making financial sense of the future

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Covenant in practice

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Covenant in practice....

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2. Legal obligation
3. During a valuation
 - Establishing “reasonable affordability”
 - Linking covenant to assumptions
4. In between valuations
5. Covenant and the sponsor approach
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Theory and practice

Regulatory guidance and actual experience

- Recent comprehensive guidance from tPR
 - Change of emphasis on definition of covenant
 - Increased focus on the “governance” of covenant
- In theory employer covenant strength should drive:
 - Overall prudence of technical provisions
 - Length of recovery plan
 - Extent of risk in investment strategy
- Practical application often differs from theory
 - Reverse engineered valuations, driven by affordability
 - Conflicted trustee boards, with limited covenant review.

Legal obligation

UK employer/overseas parent

- Not an unusual arrangement
- UK employer may have limited assets
- Profits typically remitted overseas via loan or dividend
- Restructuring may move cash / assets / profits out of the UK
- Trustee concerns about ongoing presence in the UK
- How easy is it to extract a guarantee?
- What other “ties” are there between UK and group/parent

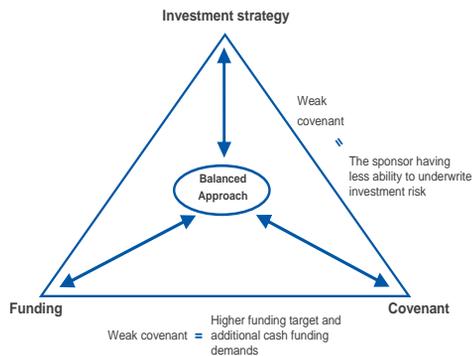
- tPR is taking an aggressive stance on covenant review

During a valuation Establishing “reasonable affordability”

- Blending financial analysis and judgement to find the right balance between competing stakeholders
- How robustly should trustees negotiate
- How often are forecasts available? How reliable are they?
- Important to demonstrate rigorous process
- Use of contingent assets and profit sharing arrangements.

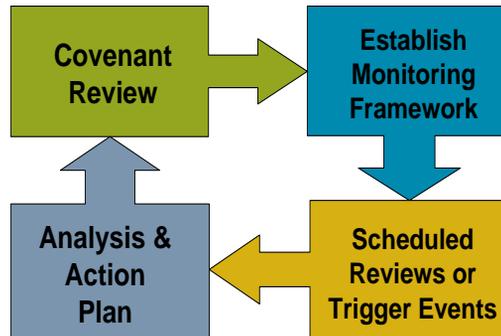
During a valuation Linking covenant to assumptions

- Ways of measuring and ranking covenant
- How does this marry to the assumptions?
- How does tPR look at things?
- Covenant between valuations and how this impacts assumptions



In between valuations Monitoring in practice

- What is best practice?
- How frequently?
- How much information?
- Use of triggers and what actions to adopt?
- How prescriptive?
- Getting employers to engage
- Implementing contingent assets



Covenant and the sponsor approach Proactivity, asset and liability management

- Scheme sponsors are taking a more proactive stance
- Active engagement in the provision of information
 - ensuring covenant strength is properly presented
 - Well prepared to defend level of affordability
 - prepared to risk tPR engagement
- Wide range of available (employer lead) options for management of assets and liabilities
 - Special purpose vehicle funding, alongside traditional contingent assets
 - ETVs, pension increase exchange, hedging etc.

Covenant in transactions

Where are tPR's powers being wielded?

- Key requirement remains to compare pre and post-event covenant
- Contrast between detrimental and materially detrimental
- Significant reduction in clearance applications
- What powers does tPR have?
- How and when are they prepared to use them?
- What powers do trustees have?

Questions or comments?

Expressions of individual views by members of the Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

