

Pension Credit Advisory

# *The outlook for covenant*

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Strictly Private  
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## *Your presenters*



Mark Jennings



Matthew Cooper

## Overview of the session

- What is employer covenant?
- Recent covenant guidance
- Long-term covenant – megatrends
- Managing covenant risk – best practice

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## How does the Pensions Regulator define employer covenant?

**In the February 2006 code of practice “Funding defined benefits” it was:**

*“an objective assessment of the employer’s financial position and prospects as well as his willingness to continue to fund the scheme’s benefits”*

**This is how the Pensions Regulator defines covenant in the 2015 covenant guidance:**

*“The extent of the employer’s legal obligation and financial ability to support the scheme now and in the future.”*

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## TPR's guidance at a glance:



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### ***Assessing the covenant – areas of focus***

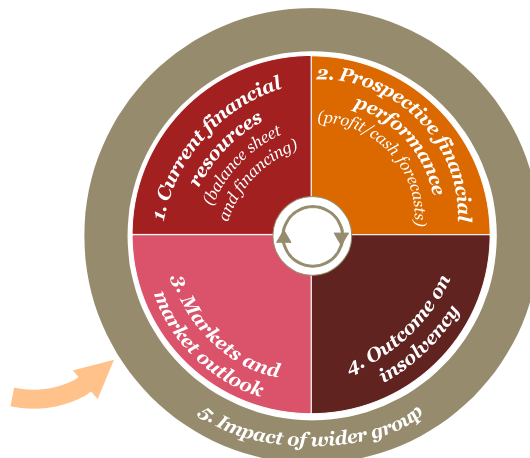
## ! *Employer's legal obligations*

- Legal basis of contributions and s.75 debt
- Wind-up rules
- Guarantees
- Informal support

@ **Funding needs and investment risk**

- Assess covenant in relation to funding needs, investment risk, maturity of scheme

## # Financial support from employer/other entities



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***tPR’s new guidance - areas of emphasis***

Focus is on ability to contribute cash

Guarantees should help to determine affordability of DRCs

Covenant should reflect scheme context

Limited reliance on indirect/‘soft’ covenant

Sustainable growth and equitable treatment of stakeholders

Trustees should consider their approach to covenant carefully



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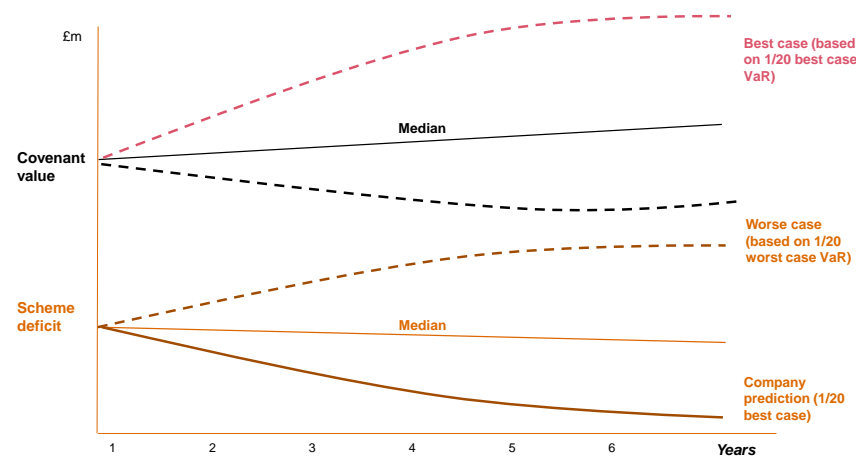
***What does this mean for individual schemes:***

*“The approach taken by the trustees should be proportionate to the level of reliance placed on the covenant to support the scheme’s funding needs and investment risk.”*

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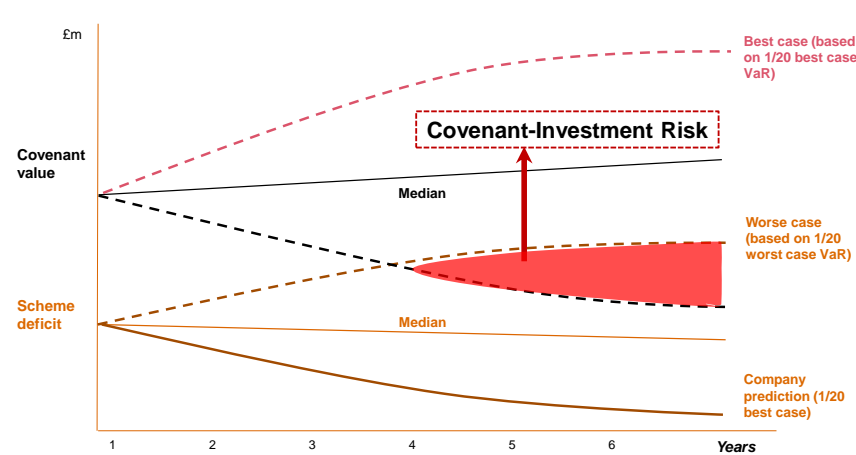
**How do you conclude if the covenant can support the investment strategy? – Company A**



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**How do you conclude if the covenant can support the investment strategy? – Company B**



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**Megatrends – what are the long term risk factors for your covenant?**

All aspects of all businesses are impacted by global megatrends

We have identified **five global trends** that are:

- having a major influence on the economic and commercial landscape;
- permeate across all sectors of the economy and society; and
- fundamentally disrupt our industry and the way we do business.



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***The Code of Practice encourages Trustees to think about scenarios which could jeopardise the position of the scheme:***

*“Trustees should have a view on the range of likely adverse outcomes that could apply and have an adequate and flexible strategy and governance structure to address these outcomes.”*

**Covenant risks and protections**



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***Session summary: The outlook for covenant***

***The new guidance:  
building on best  
practice***

***The guidance shows the  
focus of tPR with new  
areas of emphasis***

***Understand risks for  
covenant in the long  
term***

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***Your presenters***

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