

## Covenant reviews

Trustees' responsibilities with regard to assessing employer covenants are set out in The Regulator's Code of Practice "Funding Defined Benefits", the key sections being as follows:

- "Trustees should aim for any shortfall to be eliminated as quickly as the employer can reasonably afford. What is possible and reasonable, however, will depend on the trustees' assessment of the employer's covenant." (Paragraph 101)
  - "It is essential for the trustees to form an objective assessment of the employers' financial position and prospects as well as his willingness to continue to fund the scheme's benefits (the employer's covenant)." (Paragraph 57)
  - "If negotiation proves necessary, trustees should be well prepared." (Paragraph 64)
- iii. Cashflow impact of significant financial instruments.
  - iv. Effect of security charged against the company.
  - v. Distribution policy (dividends).
  - vi. Inter-company trading dependency.
  - vii. Impact of a foreign parent.
  - viii. Scale of the deficiency, relative to the size of the entity.
  - ix. Level of contributions relative to historic corporate cashflows.
  - x. Impact of audit report modifications.

### *Follow Up Services*

Once an initial assessment of the solvency risk has been made, subsequent advisory services could include:

- i. Examination of management proposals for eliminating the deficit.
- ii. Review of management forecasts and other management information.
- iii. Detailed assessment of the ability to pay.
- iv. Assessment of the employer on a break-up basis (the "what if" scenario).
- v. Asset valuations, including subsidiaries.
- vi. Preparing integrated financial models if management forecasts are insufficient.
- vii. Assistance to the trustees in negotiating a recovery plan.
- viii. Advising the trustees on establishing an ongoing flow of information from the employers.
- ix. Advising trustees on the availability of security.
- x. Advising trustees in dealing with the Pensions Regulator.

Services forming part of the initial covenant review process can be undertaken on a desk-top basis or by the provision of information directly by the employers, including formal meetings with the employer. Subsequent advisory services will almost inevitably require the provision of information from, and hence co-operation of, the employer.

*"Excellent...clear report...you dealt with the key issues."*

*The Pensions Regulator*

The limited availability of formal advice as to the content of a review is an advantage to the trustees in that they can be flexible, but also a disadvantage in that it is difficult for trustees to be confident that they have undertaken a sufficiently thorough exercise whilst operating within reasonable financial and time constraints.

With this in mind, we are working to provide a bespoke service for trustees in terms of understanding group structures, the implications of security, financial forecasts, break-up of balance sheets and the impact of inter-group funding arrangements, combining our detailed pensions understanding and corporate recovery skills.

### **Corporate Advisory Services: Moore Stephens LLP**

Within the overall employer covenant assessment our own services fall into two categories: the initial covenant review and follow up services:

#### *Services Forming Part of the Initial Covenant Review*

As part of the covenant review process, it is vital for the trustees to understand the legal context in which the specific employer operates. Our review can cover:

- i. Group structure.
- ii. Inter-company cross guarantees.

*"We are very pleased with the work you have done."*

*Chairman of Trustees*

*The solution is for trustees to have a 'building-block' service that develops as the review process progresses.*

### **The Building-Block Approach**

The flexible nature of the service means that trustees can choose the level of service they want. Some trustees will only want a brief health-check on their sponsors, while others will want comprehensive advice. The solution is for trustees to have a 'building-block' service that develops as the review process progresses. This starts with a clear understanding of employer solvency risk, which can then be enhanced to consider the employer's ability to pay, the scheme's security as a creditor and the availability of contingent assets.

In our view there is no loss of financial economy, in terms of fees, to the trustees from using such an approach.

### **Value for Money**

Value for money comes first by ensuring that the precise requirements of the trustees are understood and then by building a bespoke service to address those requirements.

### **Our Credentials**

Moore Stephens LLP is a member firm of Moore Stephens International Limited, one of the world's leading accounting networks, with worldwide growth of 66% in the past two years, making it the 11th largest network.

Services to the pensions sector now form a significant part of the business of Moore Stephens LLP, and our clients continue to increase both in terms of number and size of scheme. Our services include audit, accounting, banking, payroll, internal control, forensic investigation and covenant reviews. Moore Stephens' commitment to providing trustees with a quality service is evidenced by an outstanding client retention rate.

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