

The Trustee toolkit downloadable

How a DB scheme works

Scenario two

In this scenario you will learn about the information you need to monitor the strength of the employer covenant.

As you work through this scenario you will be tested on your knowledge at decision points. Here you will have the option to work through a related technical tutorial before returning to the scenario or you can skip the tutorial. You can always work through the tutorial separately later if you would prefer. This scenario includes two tutorials:

- ▶ Employer covenant
- ▶ Risks to employer covenant

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at www.trusteetoolkit.com

The Pensions
Regulator

Message from Alicia

Tony has emailed the agenda with a short note.

Agenda

1. Minutes of last meeting
2. Matters arising
3. Report of meeting with MD
4. Update on the financial position of the employer
5. AOB

Alicia has asked to talk to you as she is becoming increasingly concerned about the valuation and the financial situation of the employer.



Alicia says: "I hope you don't mind my calling you up out of the blue? Rodney's often away, and in any case he's really only bothered about the pensioners. Charlotte's not around and Edmund's always busy. What I'd like is to get to grips with all this funding stuff, and I thought you'd be able to help me. Do you mind if I pick your brains a bit? I feel less self-conscious about talking to you."

Do you think we're heading for trouble? And if we are, what's the best thing to do for the active members? I've heard the MD isn't well. As he's the sole owner and founder of the company, I'm worried that if he leaves it'll make it worse."

The meeting is convened

Having heard what Alicia has to say, you encourage her to raise her concerns at the next meeting. She does so under the second item: 'Matters arising.'

Alicia says: "I know that we're approaching Mr Davis to arrange paying off of the deficit, and I know you're going to report on that in a minute, Edmund. I hope you don't mind but I just thought I ought to say that I'm still very concerned about the active members' benefits."

Rodney says: "I agree, and I'm concerned too. As far as I can see, we're all in this together, and what's good for the active members is also good for the pensioner members."

Charlotte says: "You're quite right to express your concerns Alicia, and we all share them. That's partly why I put item four on the agenda."

Edmund says: "Which I'm afraid now has to become item three. My meeting with the Mr Davis has had to be cancelled, as he's ill. It's not the first time my meetings with him have been cancelled due to his ill health."

Alicia says: "I heard he's absent quite frequently now, and this is starting to have a negative impact on the business. The sales director resigned last month, which isn't a good sign."

Edmund says: "Well, there isn't much we can do until he is back at work, so perhaps we should move straight to the update about the company's financial position." It occurs to you that Edmund seems rather strained and abstracted, but the moment passes and Charlotte is introducing the item about the company.

Charlotte says: "I put this on the agenda because I think that, given the current financial situation of the employer, we need to monitor financial information about the company a little more carefully than we have done up to now. To do this, we need to consider where we currently get our information from, and whether we need to augment it with information from other sources. And this relates to Alicia's concerns about the benefits of active members. In effect, as we all know, the scheme is an unsecured creditor of the company, like a trade supplier, and upon insolvency would rank behind any secured creditors. It is crucial that we have good visibility of the strength of the covenant supporting the scheme and that we are aware of any issues that may affect it."



Decision point: Checks and balances

After quite a long discussion, the trustees come to some conclusions about how they should be monitoring the financial health of the company. Which three do you think are correct?

1. As long as Edmund meets the MD regularly and he's comfortable with the situation, we need do nothing
2. We should keep an eye out for material events that may impact the company, eg suppliers no longer willing to give credit
3. We should monitor the company's financial statements and management accounts to understand the performance of the company
4. We should request regular formal and minuted meetings with the MD's representative here at the company and have regular written updates

[Answers at the back](#)



Need help with this question? Read the [Tutorial 'Employer covenant'](#)

An unscheduled meeting

It's not so long since the last meeting, but you know that Mr Davis is seriously ill and things at the company seem to be getting worse, so you're not all that surprised when you get an email from Tony: 'Charlotte has asked me to call an emergency meeting of the trustee board. Please let me know if you're not available next Thursday morning. She will be contacting you individually to brief you. It's to do with Mr Davis's illness. It seems that it's very serious. As you know, he's not just the MD, he's the sole owner of the company. So there are implications we need to discuss.'

You arrive at the meeting, and see that everyone is there except Edmund. Charlotte explains why she's called the meeting. She says: "You all know that Mr Davis is seriously ill, and as sole owner and the key driver of the business, if he is unable to return to work it could have repercussions for the business.

In addition, we've been alerted to a material event. The biggest customer of the company has taken its business to a competitor. This is due to ongoing late deliveries, deteriorating product quality and fears that Mr Davis will not be here to steer the company back on track.

One of the reasons Edmund isn't here is that he's with the finance team looking at the last nine months' management accounts. The company is expected to make significant losses going forward as a consequence of the loss of the customer. As trustees we need to consider the implications of this situation, and discuss what steps we need to take to protect the scheme as the employer's covenant deteriorates."

All of you, except Rodney, who isn't often around the office, had heard something about the implications of the loss of the customer. Nevertheless, Charlotte's words have come as a shock.

Adrian says: "I understand that Edmund is very busy, but I'm surprised he can't make time for the trustee board."

Alicia says: "I don't suppose it's because he's busy. Remember, ages ago he said that he'd absent himself from meetings if he felt more than usually conflicted."

Charlotte says: "That's exactly it. We're going to have to make some important decisions, and as the director acting on behalf of Mr Davis, Edmund doesn't feel able to take part."

Rodney says: "But that's a blow isn't it? Presumably he knows more than anyone else about the company's situation. We need his input."

Charlotte says: "And we'll get it. We've all signed a confidentiality agreement, so he (on behalf of the company) is prepared to give us any information we ask for. He just can't take part in our discussions and decisions. It is a great loss to us, I agree, but he doesn't really have a choice. I think we need to consider what we should do to compensate for Edmund's absence. We also need to think about what actions we should take now to protect the scheme."



Decision point: A deteriorating covenant

You and your fellow trustees discuss the steps you should take to protect the scheme as the covenant deteriorates. Which four of the following actions would you agree with?

1. Ask the actuary to do a full valuation of the scheme's liabilities
2. Check the scheme's ranking in the order of creditors
3. Check the trustees' powers to wind up the scheme
4. Increase the regularity of updates from the employer
5. Instruct a covenant adviser to advise on the impact of recent events on the employer's covenant
6. Seek clearance from The Pensions Regulator (TPR)

Answers at the back



Need help with this question? Read the [Tutorial 'Risks to employer covenant'](#)

Rounding up

You and your fellow trustees have decided what steps you will take to protect the scheme as the covenant deteriorates.

Now that you have completed this scenario we would recommend that you begin to work through the 'Check your scheme' worksheet for this module.

Answers

Decision point: Checks and balances

The first answer is incorrect. The company should keep the trustees informed of matters relevant to the scheme and the strength of the employer's covenant. The trustees have a duty to use that information responsibly, and not to use it for their own purposes.

It is a good idea to have written information from the employer, together with formal and minuted meetings with someone representing the employer.

You should monitor financial information about the company, provided that it's relevant. You need to keep a sharp eye out for any material events that might impact the company, like suppliers no longer providing credit.

It is not Edmund's sole responsibility to monitor the company's financial situation, it is the responsibility of each trustee and each trustee should share any relevant information that they learn with the other trustees.

Decision point: A deteriorating covenant

The first and last answers are incorrect.

Trustees should seek to understand the changing circumstances of the company by obtaining more regular updates on the situation and professional advice on the change to the employer's covenant. Until that advice has been received, it would not be appropriate to consider going for a full valuation of the scheme's liabilities, as any change to the employer covenant may affect the technical provisions used in any valuation.

It is worth checking the trust deed and rules to determine what powers the trustees have to wind up the scheme in case this becomes necessary. The trustees should also check the scheme's relative position among the creditors of the employer, both in relation to ongoing funding commitments and in the event that the company goes into insolvency.

It is for the employer to seek clearance from TPR if it thinks it necessary. The trustees may still wish to approach the employer to seek mitigation for the deteriorating covenant.