



Punter Southall  
TRANSACTION SERVICES



Clear and pragmatic advice



## Covenant advisory services

Experts in assisting companies present the covenant to pension scheme trustees with the aims of satisfying regulatory requirements and reaching an agreement with regards to scheme funding or corporate activities.

### Why is the employer covenant assessed?

The covenant – defined as the employer’s legal obligation to its pension scheme and ability to meet them – is a critical factor for trustees when making decisions regarding the scheme’s funding and investments. The **strength** of the covenant support provided to the scheme determines the **degree of prudence** trustees should use in the valuation of the scheme’s liabilities and the **level of risk** that they can take in the scheme’s investment strategy.

### When to assess the employer covenant?

Covenant reviews are triggered by either employer or scheme related activities; the actuarial valuation being the most common example.

#### Corporate events

- Merger or acquisition
- Divestment
- Refinancing
- Restructuring
- Deterioration of trading performance
- Dividend payment or share buy-back

#### Scheme events

- Triennial actuarial valuation
- Investment strategy review
- Apportionment arrangements
- Withdrawal arrangements
- Transfer value calculations
- Scheme merger or scheme closure

These events will require trustees to make certain decisions regarding the scheme, taking into account the **strength of the covenant** or any change therein. However, sponsoring employers can benefit from **leading the discussions** in this area and presenting their thoughts on the covenant to the trustees.

## How we can help

Our team of covenant experts can assist employers to [formalise the covenant assessment process](#) with the trustees and [prepare a suitable covenant review](#) that satisfies the relevant regulatory requirements. We also help employers in funding discussions with their trustees by ensuring that the strength of the [covenant is properly reflected](#) in the actuarial assumptions and that the level of prudence applied is not excessive.

### As part of our covenant advisory services we:

- Prepare formal covenant reviews for (or with) our corporate clients to support the trustees' decision making
- Highlight strengths resulting from the company's financial policies, capital structure, asset base or cash flows
- Demonstrate and explain the benefits of capital investments in the business for the scheme
- Outline the wider industry or sector prospects and provide a summary of the company's business plan
- Negotiate with the trustees the length and structure of a mutually acceptable recovery plan
- Lead on discussions with the Pensions Regulator and prepare any clearance application (if needed) in relation to corporate activities

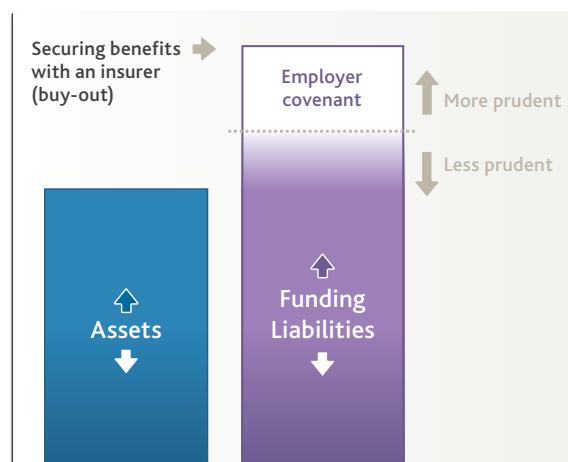
## The two key areas where employers seek our covenant advice are corporate transactions and actuarial valuations

[Actuarial valuations](#) tend to start with a covenant review and the outcome of that exercise can heavily influence the trustee's view regarding the [actuarial assumptions](#) and the scheme's recovery plan. Trustees are expected to set the level of prudence in measuring the liabilities to reflect the strength of the covenant.

"Thanks for your help with the presentation. I was very pleased with the meeting with the trustees yesterday and accomplished all that I had hoped for. You made this very easy for me with the material you prepared. I appreciate your excellent work."

**Director of Finance**

Our specialists can assist employers by taking a pro active approach and [leading the discussions](#) throughout the valuation exercise. We also help employers when, following the calculation of liabilities, discussions with the trustees move to determining the level of cash contribution required by the scheme and to how much the employer can [reasonably afford](#) to pay.



[Corporate transactions](#) have the potential to affect the strength of the employer covenant or at least the trustee's view on it. Trustees are expected to assess the covenant implications of these activities and [seek mitigation](#) if there is any material weakening in the covenant. Furthermore, some of these activities may also fall into the category of '[materially detrimental events](#)' when, according to the Pensions Regulator, applying for clearance is a relevant consideration for the employer in order to avoid future regulatory intervention in the form of a financial support direction or contribution notice.

## Case study – Actuarial valuation



### Background

One of our corporate clients felt that the trustees' advisers were following a one-dimensional approach to the covenant assessment, focusing largely on historical financial statements, which resulted in missing many key

factors that were relevant to the covenant.

### Assessment

We assisted the employer by preparing a broader and more forward looking covenant review, which presented the covenant from a different angle,

balancing out some of the past performance with future business plans. This included some industry benchmarking, as well as relevant information and financial measures regarding the company's business plan, order book, existing contract portfolio, and the way these can be relied upon both directly and indirectly by the trustees.

### Outcome

This provided a further insight for the trustees that they did not previously have access to. It led to a revised set of actuarial assumptions which made both parties comfortable with the mutual views on the covenant strength and the way this was finally reflected in the valuation.

## Case study – Corporate transaction



### Background

Our client was intending to pay a special dividend as part of its financial restructuring. However, prior to that they wanted to achieve certainty on the implications for the pension scheme, the relevant regulatory requirements and the appropriate actions for them.

### Assessment

We undertook a review of the strength of the employer covenant supporting the pension scheme both immediately before and after the proposed special dividend payment. Key areas of our analysis included:

- The materiality of the dividend payment
- Appropriate forms of mitigation that could be offered to compensate for any reduction in the covenant strength

- Communications of the proposed dividend payment to the trustees
- The appropriateness of applying for clearance
- The need to notify the Pensions Regulator

Our analysis revealed that the proposed special dividend payment would not result in a material weakening of the covenant supporting the pension scheme. Whilst it was not necessary for our client to offer mitigation to the scheme we advised our client to engage with the trustees to avoid any potential confrontation should the trustees consider that due consideration had not been given to the pension scheme.

### Outcome

Our client was able to share our covenant review and advice with the Trustees who accepted the reasoning and conclusions reached without the need for further, potentially costly and time consuming, advice and negotiations.



## Lorant Porkolab, Senior Consultant



Lorant leads the covenant advisory services of Punter Southall. By background he is a Chartered Financial Analyst with several years of corporate finance experience. He advises both corporate and trustee clients, focusing

on covenant assessments, corporate transactions, pension strategy and negotiation support.

Lorant has assisted employers with assessing the covenant implications of corporate transactions,

preparing covenant reviews in the context of actuarial valuations, and leading discussions on covenant related matters with the trustees and their advisers. He has also helped employers with identifying and negotiating proportionate mitigation for material weakening of the covenant, exploring the use of contingent assets and discussing deficit recovery plans with trustees.

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## Richard Jones, Principal



Richard is the Managing Director of Punter Southall Transaction Services. He has worked in the pensions industry for over fifteen years and has spent twelve years at Punter Southall, including a spell in the US.

Richard has been involved in a large number of international mergers and acquisitions particularly

involving UK and US interests for both corporate buyers and private equity firms. Since establishing Punter Southall's employer covenant advisory services offering in 2008 Richard has provided employer covenant advice to a large number of clients in a wide range of industries.

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## Jacqui Woodward, Senior Consultant



Jacqui is a qualified Actuary in Punter Southall Transaction Services with more than 10 years' experience in advising on employer covenant and pension issues, including a period in the US where she

worked primarily on international transactions and accounting coordination.

Since returning to the UK, Jacqui has assisted a number of UK corporations with the management of their UK pension liabilities covering areas such as their PPF levy, negotiating with trustees during the scheme specific funding process and providing advice on clearance.

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