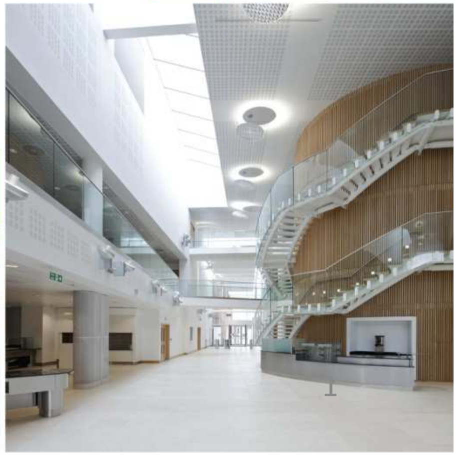
Employer Covenant

Local Government Pension Scheme



Covenant – What is it?

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

Source: The Pensions Regulator

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Covenant – Who’s covered?

- <u>All</u> Employers:
  - Admission Bodies
    - Transferee (Contractors)
    - Community (charitable bodies and those with a not-for-profit remit)
    - Social Housing Employers
  - Scheme Employers (as defined in regulations)
    - Councils / Parish Councils / Fire Authorities / Police & Crime Commissioners
  - Higher / Further Education Establishments
    - Colleges / Universities (not public Sector Employers?)
  - Academies

- We are not just looking at the short term solvency of the employer but also the scheme’s affordability on it and the effect on its ability to continue as a going concern

Covenant – What’s assessed?

- The ability for an employer to make good on it’s pensions obligations should be continually monitored, there are also other trigger points:
- Many aspects of an employer can be assessed and monitored.
  - Audited Accounts
  - Financial Forecasts (Short / Medium / Long Term)
  - Credit Ratings
  - Employer financial Governance
  - Internal commercial Governance
  - Local knowledge
- Employers should be forthcoming to the Pension Fund with any information that could effect its ability to meet its obligations

Covenant – What's assessed? (Cont)

- Trigger Points
  - Entry / Pre-entry to Fund
  - Merger / Acquisition of a Scheme Employer with another
  - Bulk Transfers
  - Exit plan – Monitored employer close to having zero employees
    - Arrangements agreed by Fund and Employer to achieve a level funding ratio
  - Exit of the Scheme Employer (Final covenant assessment)

- Since the Pension Regulator issued its guidance on covenant, there has become a far greater emphasis on 'de-risking' than ever before and for many Funds, this will be the first time the issue has been raised.

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Covenant – Mitigation

- The Fund needs to ensure it and its employers are not at Risk
- Pension Fund Liability – Unsecured Creditor in an Insolvency
  - Admission Agreements (where appropriate)
    - Fit for purpose? Enforceable?
  - Security (where debt is triggered)
    - Pension bond / indemnity
    - Charge / lien against an asset
    - Guarantee (formal arrangement / default / government)
    - Parent Company Guarantee

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Covenant – Funding Strategy

- The purpose of the FSS is:
  - To establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
  - To support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
  - To take a prudent longer-term view of funding those liabilities.

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Covenant – Next Steps

- Funding Strategy Statement review
  - Is the one size sits all approach still appropriate?
  - Can employers afford nearly constant employer contribution rates – is this even possible in the current climate?
    - Aon Hewitt

- Design, consult on and agree a formal covenant process
  - The governance and risk monitoring measures are clear
  - Buy in from Pension Fund Employers

Covenant – Comments

- There are processes in place which deal with some of what would be considered in a full covenant review.
  - Valuation (sets the Contribution Rates for 3 years)
  - Levels of required bond / indemnity are regularly reviewed
  - What current reviews do not really take account is the financial stability and the covenant an employer can afford to give to the Fund and this would be a relatively new concept.
- Scheme / Employer engagement is key and the requirements of the Fund and the ability of an employer to fulfill these requirements requires demonstrable and accurate management.
- With all schools likely to convert to become an academy in the next 4 years, an increased reliance on the employee led ventures the employer numbers could double over that period.

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