Pension Protection Fund

Important areas for trustees' action

Contingency planning for employer insolvency

Planning when times are good

Good risk-management is a key characteristic of a well-run pension scheme and an important part of a trustee's role.

It is essential that trustees regularly review the strength of the employer covenant and the appropriateness of the pension scheme's risk appetite so that member benefits and scheme assets are properly protected.

As The Pensions Regulator (TPR) makes clear, running a pension scheme can be complex and challenging, and this is particularly true where the employer is in difficulty. It is important that trustees understand the sorts of challenges they will face when there is an increased risk of the employer suffering an insolvency event. These can be very different to those faced when the employer covenant is strong and the business stable, and the trustees may have no experience of handling the issues that result from such a situation.

When an employer looks to be failing it is important that trustees look critically at the way they run the pension scheme, reviewing whether the trustee board composition, and relevant structures and processes that are in place, remain fit for purpose. Specifically trustees need to consider the particular risks posed by the employer's financial situation and ensure that the trustee board has the right mix of skills, knowledge and expertise so that robust and timely decisions can be made in the members' interests.

Are you prepared?

Over time the PPF has seen pension schemes in varying states of readiness for their employer becoming insolvent. We understand that trustees may think that they will never be placed in this position and that they have the relevant skills and experience to deal with any situation they are faced with. Unfortunately our experience tells a different story. We regularly see trustees that aren't well prepared, and as a consequence are ill-equipped to handle the issues that result from employer distress. This leads to poor member outcomes at precisely the time members are most likely to need reassurance that their pension is safe.

We would advocate contingency planning to think through what challenges might surface should there be an issue with the employer. We would recommend doing this thinking while the employer is stable, and having articulated procedures and responses to issues in advance. As with any sensible business continuity or disaster recovery planning, these can then be taken off the shelf and used should the situation arise, rather than being developed at the time when there will probably be many other competing priorities and matters to consider. Your advisors should be able to help with this, and we would be happy to be involved too.

The rest of this document discusses what happens if a scheme's employer looks like it might become insolvent, and the issues we think should be thought through in advance that will make a difference to members.

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As a result of the planning we did in advance, all members received a written letter from the trustees explaining the impact of the administration on their position and pension entitlements the day after administrators were appointed.

(Trustee, 2018)

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As trustees we had a key role to play in ensuring appropriate contingency planning was undertaken to deliver an orderly entry into PPF assessment and to minimise potential disruption on members.

(Trustee, 2018)

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What happens when a scheme's employer becomes insolvent

Should an employer of an eligible defined benefit (DB) pension scheme become insolvent, what is known as a PPF assessment period starts.

During the assessment period we determine whether or not there are sufficient assets to meet PPF liabilities. If there aren't, the scheme transfers to the PPF and we then administer the compensation arrangements for members. The average assessment period takes 18 months. We work alongside a panel of PPF specialists – trustees, administrators, actuaries, auditors, lawyers and a member tracing agency – to take the scheme through the assessment period.

In the very early stages of the assessment period we work with trustees to ensure that the scheme is eligible for PPF assessment, and that appropriate governance structures are in place. As we move through the assessment period we verify that the benefits paid are in line with the scheme rules, and that any rule changes have been executed properly. We can then do a proper comparison of the asset and liability position. In the majority of cases, some benefits are not paid at the right level and we need to rectify them, usually but not exclusively in the members' favour.

In a minority of cases there is a planned entry into PPF assessment and we are able to work with the trustees to make sure there is a smooth transition, members are communicated with effectively and efficiently and there is no break in payments to pensioners. Mostly, however, we don't have advance notice of insolvencies and we get in touch with the incumbent trustees once we receive the appropriate notification.

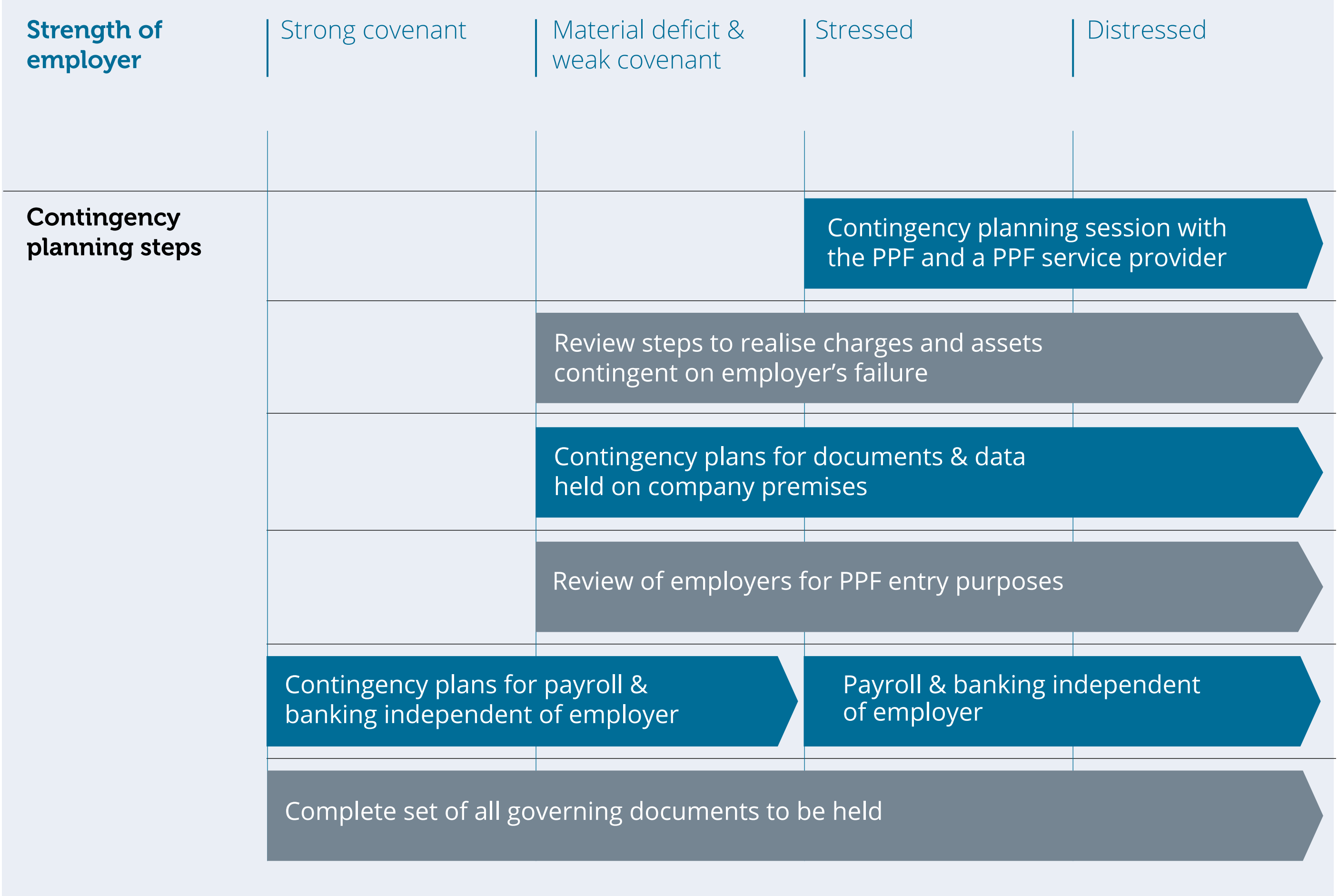
Evidence shows that if trustees have thought about what it means to enter a PPF assessment period, irrespective of whether it is planned or not, and undertaken some contingency planning, it is more likely that there will be a consistent member experience and assets will be safeguarded.

As an example, we have seen in-house pensioner payrolls put at risk because the employer has been made insolvent without warning and access to the employer's premises is lost along with the IT and the finance, payroll and banking functions. Sometimes the bank freezes the account from which the payroll is made. We have had to step in on over 10% of cases in recent years to make sure that the pensioners are paid.

> Our early engagement with the PPF was key to delivering the best outcome for scheme members.
>
> (Trustee, 2018)

This guidance provides information about the simple but effective steps that we recommend schemes put in place to mitigate some of the risks resulting from employer distress, particularly those areas which affect members and risk delaying completion of a PPF assessment period.

Figure 1: Contingency planning steps



Contingency planning steps

> Working with the PPF we were able to set up a contingent payroll with a panel provider to ensure pensions would always be paid, irrespective of what happened to the company.
>
> (Trustee, 2018)

Governing documents

The law requires trustees to be familiar with their own scheme's policy documentation and TPR expects trustees to have a working knowledge of those documents so they are able to use them effectively when carrying out their duties as a trustee.

We will need a subset of your scheme's governing documents as soon as your employer becomes insolvent, followed by a complete set of governing documents so our specialist teams can carry out the tasks undertaken during the scheme's assessment for potential transfer to the PPF. If a scheme has poor documentation, this might delay its entry into an assessment period. This in turn may delay communication to members at what will be a particularly worrying time for them. **Steps taken to list and collate all of your governing documents, and for them to be held in more than one place, will provide a smoother entry into the assessment period.**

Payroll and banking

We often see issues with payroll and we recommend you review your arrangements so you are confident that your payroll could still be run if your employer fails. This becomes critical when the employer employs an in-house administration team. When an employer fails it is unlikely the company payroll function will continue to operate for very long. In addition if the trustee bank account is operated on the employer's online banking platform, even though this is a separate bank account, access to all accounts on the company's online platform are likely to be frozen.

You should take steps to ensure that there is access to the member payroll information and that sufficient funds are available. You may also want to consider setting up a separate account and holding 3 months' worth of payroll if insolvency looks imminent and payroll is run in-house.

Review of employers

If, over the years, your scheme has had a number of different participating employers, you will need to be able to show clearly how these employers have joined and exited the scheme. There are many examples of cases that have entered the PPF where the history of participating employers is not clear, nor is it possible to work out whether debts were triggered or payments made when former employers exited the scheme. Without this information, we cannot confirm whether members previously employed by those employers are eligible for PPF compensation. Subsequent evidence would need to be provided and a legal review would be carried out. These cause unnecessary delays to a scheme entering an assessment and members receiving the comfort that they are protected.

It is important that you understand which employers remain attached to the scheme and which members are attached to each employer.

Case study

We had a recent case where two trustees of a scheme that entered PPF assessment thought they had resigned from their positions before the employer insolvency. But in fact they had not, because the deeds removing them had not been executed properly. This meant that there was no-one in place to take decisions at the early stages of assessment, and there were on-going delays with issues such as member communications. To resolve this we needed to gain the support of the existing trustees for a short period. This allowed us to remove and replace them with a PPF specialist, the whole time communicating effectively to members to help them understand the reasons behind some of the delays.

> To mitigate the risk of the company failing and the trustee losing access to scheme information, a specialist third party administrator took a complete copy of our administration system and payroll information. We also obtained a copy of all microfiche records and member records.
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> We found that early planning for entry to a PPF assessment period and the involvement of the PPF specialist team to advise the in-house team and trustee board was very beneficial.
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> (Trustee, 2018)

Documents and electronic data

Pension scheme documents and member files are often stored at the employer's office or on the employer's electronic network. On the insolvency of an employer it is critical that the pension scheme documents and member files are easily identified and easily extracted. This requires access to the site and previous employees, which can be incredibly challenging and time consuming after an insolvency. After an employer's failure, working with the PPF's specialist teams and the Insolvency Practitioner we might need to retrieve documents from the premises at very short notice. This task is easier if an up-to-date record of documents held is readily available and backups for electronic data are maintained.

Charges and assets contingent on an employer's failure

The employer may have given the scheme an asset or charge which is contingent on the employer's failure. Once the employer suffers the event triggering the scheme ownership of the contingent assets, our insolvency team will need immediate access to clear documentation setting out details of the assets and charges over which they have assumed creditor rights.

Some further areas which may be relevant to consider are set out below:

Trusteeship: Assess the **expertise** and experience of the trustee(s) if necessary.

Make sure the trustees have, or have access to, relevant experience in managing a pension scheme where the employer may become insolvent. Experience in Regulated Apportionment Arrangements (RAAs), Company Voluntary Arrangements (CVAs) and the PPF should be considered. There is published insolvency guidance and support, including on CVAs, on our website, www.ppf.co.uk/further-guidance-and-support

Where there are **conflicts** ensure there is appropriate governance in place. Actual or potential conflicts of interest may arise for trustees of DB schemes, e.g. when they're involved in funding negotiations.

There may be acute or pervasive conflicts associated with a trustee's role, e.g. where they are also the finance director, in respect of which they may need advice. Not all conflicts are employer related – they can also arise for trustees who, for example, are scheme members or who hold trade union representative roles.

Members: Ensure members continue to be the key priority and that they are told what is happening **promptly** then kept up to date with accurate, **clear and understandable** information and communications. Make sure enough member tracing activity has been carried out to be certain that accurate personal data is held. It is particularly important to have accurate and up-to-date addresses, as members will need to be communicated with quickly after (and sometimes before) assessment starts.

Communications: Work with TPR and the PPF, and prepare a **media strategy** if required. Gather together suggested wording from all interested parties when agreeing, for example, bulk mailing. While this sounds quite simple, doing so in short timeframes with a number of inputs to collate and consider can be challenging.

Cash equivalent transfer values (CETV): As highlighted in the report of the *Independent review of communications and support given to British Steel Pension Scheme members* (January 2019), trustees should work with TPR to provide appropriate support to members who are considering a CETV in the context of a stressed or distressed employer, or a restructuring exercise. The PPF supports the FCA's position that transfer values aren't generally in the best interests of members, and that it's important the members understand the true value of the DB pension they're giving up, as well as the substantial level of compensation available from the PPF in the event of employer insolvency.

Assets: Manage the **cashflow** position, ensuring there are clear mechanisms for disinvestment, taking into account the expected outgoings during the weeks or months ahead.

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At a glance

Do I:

1. have all my governing documents?
2. have access to payroll information and a way of paying members that does not depend on the employer?
3. need to set up a separate bank account?
4. have a complete list of which employers are attached to the scheme, and which member is attached to which employer?
5. have an up-to-date list of scheme documents and a back-up of all electronic data?
6. have a strategy for communicating with members and the media?
7. need to speak to the PPF to make sure I'm in a good place before entering an assessment period?

How can the PPF help?

For support with your contingency planning, or to understand better the impact an insolvency may have on your pension scheme and your members, contact us.

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