

# From trustee to bank manager



Trustees have a new responsibility to make themselves aware of the credit standing of their pension scheme's sponsoring company. While some trustees may have a financial background, it is important for the analysis to be objective and from a neutral starting point. David Poynton offers some help

Many trustee boards are currently grappling with questions such as:

- what information do we need about the company's finances?
- what should we do with this information once we get it?
- where should we go for independent advice and training?

The first question, though, which should perhaps be asked is: which trustees should get involved?

Pension scheme trustees' primary responsibility is to safeguard the position of scheme beneficiaries. This raises the question of ensuring that trustees have the appropriate expertise and resource to carry out their duties.

Many trustee boards include people who have a financial background, be that as former accountants, finance directors, or the like. Tasks requiring the analysis of financial information are often delegated to a sub-committee of trustees with such experience.

However, those trustees who are not party to a particular sub-committee should remember that they have to sign off on the decisions made, and should be able to at least understand what the sub-committee had been asked to do, and how they arrived at their recommendations for the wider trustee body to endorse.

Furthermore, some trustees who are current or former executives of the employer may naturally have a belief in the credit quality of the sponsor that is

influenced by the objectives of their day job or by the business' "past glories". Achieving appropriate objectivity can be a challenge for trustees in this area.

## Acting like a lending banker

The Pensions Regulator has indicated that trustees of schemes in deficit should view that deficit as similar to a debt, and have regard to the way that a lending banker would treat that debt. The starting point may be attempting to answer the following question: Could my employer take on additional debt in an amount sufficient to extinguish the FRS17/IAS19 accounting deficit overnight and, if so, on what terms?

This requires looking at the relationship between the pension scheme and the financial statements of your employer. But should we be looking at EBIT, EBITDA, PBT or PAT? All are a measure of earnings, but which is most relevant and for what purpose? What if the company is making a profit but has a net outflow of cash in the same year?

Annual reports and accounts give credit

analysts a lot of information. But remember, there can be different ways of presenting information in a manner which complies with accounting standards, and sometimes it is the information that is not in the public domain, such as management's intentions and views of future business prospects, that can be most relevant to trustee decision-making.

## Third party advice

Trustees should consider taking third party advice in areas where they themselves may not be confident, or simply to obtain greater independence and objectivity. This brings a fresh pair of eyes to the matter, rather than merely deferring to other trustees with a financial background.

Such assistance could come from a variety of sources (and at a variety of costs), such as credit analysts, chartered accountants, and ratings agencies. It is important to choose the

type of adviser that best suits your circumstances, and is flexible enough to provide the level of advice needed at a proportionate cost. Your advisers also need to have a clear understanding of the actuarial and investment implications, so that the trustees are able to make their most important decisions in an efficient and joined-up way.

## Trustee training

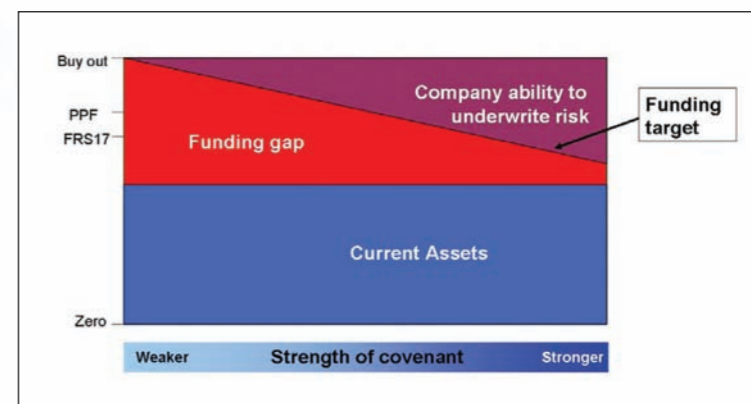
Whether you have taken advice and/or delegated assessment of your employer's covenant to a sub-committee, the trustee board will need to be sufficiently equipped to understand and act upon the recommendations.

You could consider attending a financial analysis workshop which would help you become more familiar with company accounts and know what the key ratios and trends are, to help

you determine the sponsor's credit strength. Training courses may also come with telephone support for use when you get back to the real world.

While you cannot expect to be a credit analyst overnight, trustees often value the opportunity to have exposure to an industry expert, to ask questions, and to gain an important insight into what, for some, is the mystery of company finances.

Importantly, you will understand what the company management (and your co-trustees with a financial background) are talking about, and be able to probe and ask informed questions about the accounts. You may



even find that you actually enjoy investigating the underlying picture.

Financial training may also give you a much better feel for the sponsor as a whole, a better appreciation of the challenges facing your Finance Director, the competing demands for cash, and how they prioritise those demands. You would then be able to use that knowledge in your daily life, outside of your job and your trustee duties.

## Employer covenant and scheme funding

A key outcome of the covenant assessment is to be able to look the Pensions Regulator in the eye and say, "Yes, we understand how strong our covenant is, and based on this we have negotiated the schedule of contributions accordingly".

The graph above illustrates the relationship between covenant and funding decisions.

## Insolvency scenario

The employer covenant assessment should address the level of recovery to the pension scheme in the event of the sponsor becoming insolvent. Before you say "that would never happen to us", remember that the employees at Enron and Barings did not expect their employer to fail. If this were to happen to your employer, and your scheme was not 100 per cent funded on a buy-out basis (and very few are), then benefits would be cut back. Relatively small changes in the sponsor's financial structure can have a highly

geared impact on the recovery to the pension scheme in an insolvency – this is therefore something that the regulator would expect trustees to protect against.

In summary, trustees have an obligation to understand and assess objectively the strength of their sponsor's covenant. This can be done in various ways and using various different types of adviser. It is important to find a solution that is cost effective and gives the trustee board as a whole a greater understanding of their participating employer.

Trustees will then be better equipped to deal with funding and investment issues and to negotiate with the sponsor. How much investment risk is it reasonable/necessary to take with the investment arrangements? How much advance credit is it reasonable to take for future expectations of equity out-performance? What contributions can the sponsor really afford and over what period is it reasonable to make good the funding deficit?

Finally, trustees are placing greater value than ever before on financial training, with the aim of increasing their knowledge and understanding of issues relating to pension scheme and company financing, and enabling them to question and challenge the information and advice presented to them.

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