

Covenant

North London Group - PLSA
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A business of Marsh McLennan



Today's Agenda



Covenant under the new Funding Code



Potential covenant red flags



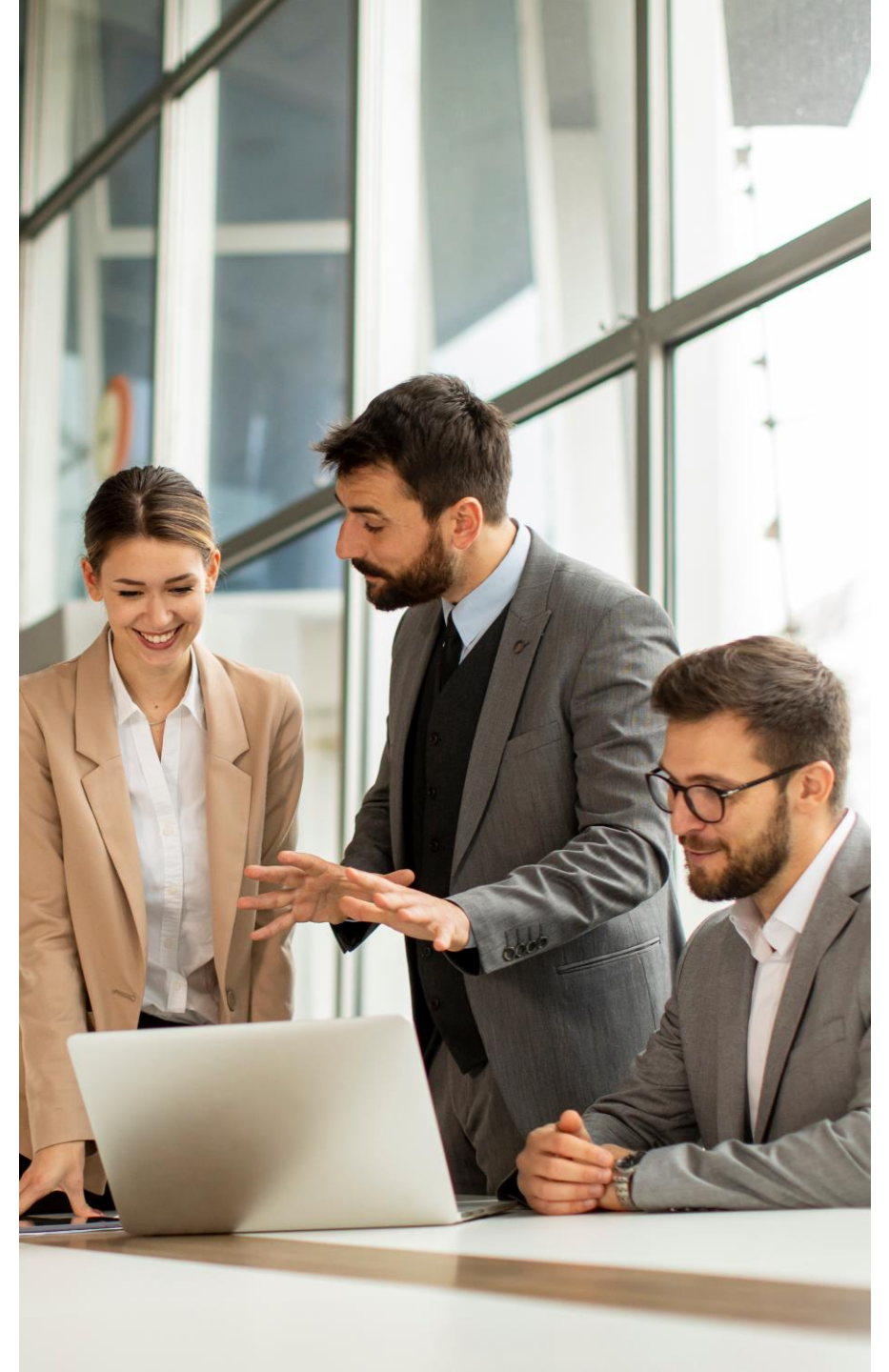
Deeper dive on contingent assets



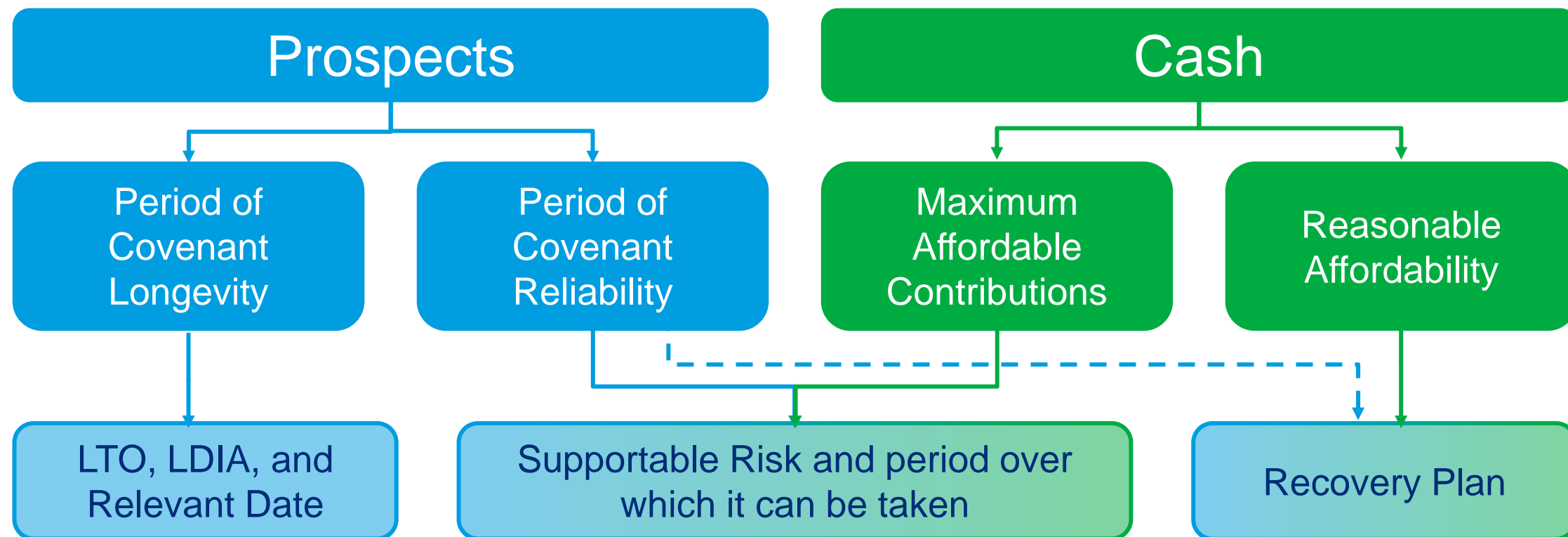
Working together



The role of covenant in scheme strategy



Covenant under the new Funding Code: framework



Contingent assets: *could impact any of these depending on nature*

Covenant under the new Funding Code: disclosure

Which schemes do not have to answer the following questions in the Statement of Strategy?

1 Is the strength of the employer covenant **adequate** by reference to the actuarial valuation to which the funding and investments strategy relates?

No exemptions!

2 What is the **reliability period**? What is the **covenant longevity**?
What are the **maximum affordable contributions** over the reliability period after deficit repair contributions (DRCs)?

Exemptions: fast track small,
fast track low risk, post-relevant date bespoke low risk

3 Information on employer **investment in sustainable growth, shareholder returns, payments to other DB schemes, other alternative uses of cash**?

Exemptions: fast track,
bespoke low risk, recovery plan shorter than 3 years (post RD)
6 years (pre RD)

Statement of Strategy can be a helpful guide for proportionality (but is just one consideration)

Potential covenant red flags

What can make covenant work more challenging under the new Funding Code?



S_{tructure}

- Complex covenant structure
- Reliance on contingent assets



S_{ponsor}

- Weak / negative cash flows
- Outlook is poor / uncertain



S_{cheme}

- High funding / investment risk
- Long recovery plan



S_{takeholders}

- Difficult sponsor relationship
- Limited sponsor information

Contingent assets: overview

Decreasing value in context of Funding Code

New gold standard

1 Look through guarantee

- Treat guarantor as employer:
- ✓ Increase Supportable Risk
 - ✓ Increase Reliability Period
 - ✓ Increase Reasonable Affordability (expect shorter Recovery Plan)

2 Contingent assets that offer quantifiable improvement to supportable risk

- Security / escrow / LOC / surety bonds
- Pre-insolvency triggers
- Contingent funding

3 Contingent assets that allow extension of recovery plan

- Can go beyond reliability period subject to access and projected value

4 Contingent assets that allow a marginally more optimistic view

- E.g. Reliability period at upper end of estimated range for employer

5 Informal support

- Not expected to support additional risk

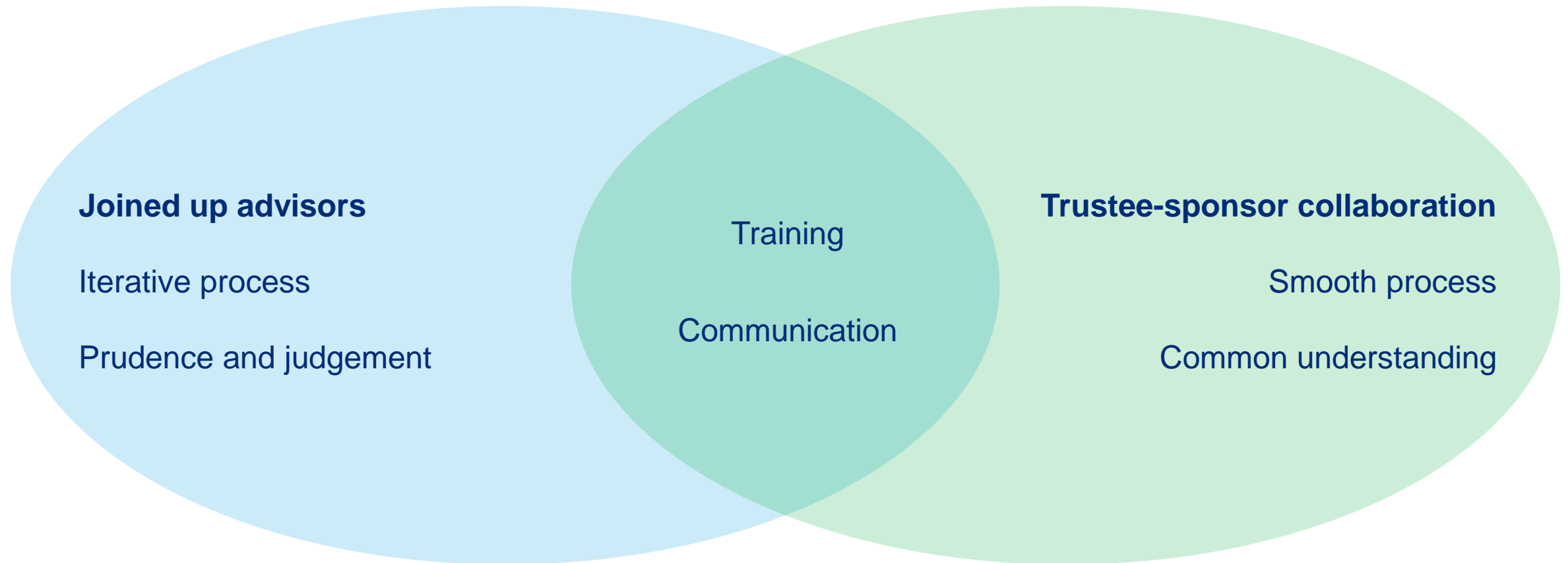
Need to be reasonably certain of value (in circumstances in which contingent asset will be called) and ability to access value to help the scheme achieve objective of reaching Low Dependency by the Relevant Date

So what does that mean for “traditional” PPF-compliant s75 guarantees...?

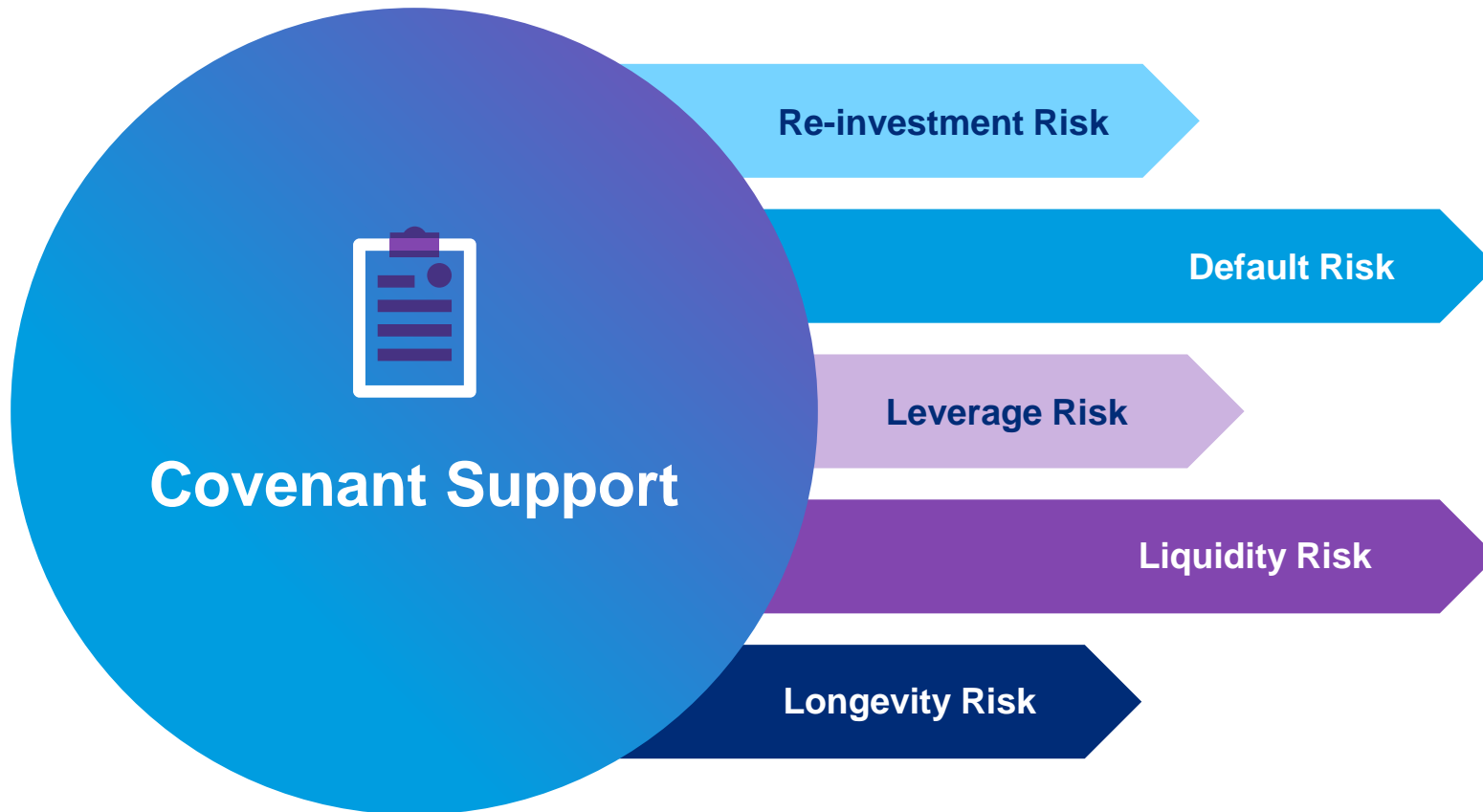
Contingent assets: look through guarantee

1. An underpin for the full section 75 deficit
2. Missed DRCs under the terms of the schedule of contributions
3. Legal mechanism enabling trustees to look through to guarantor's cashflows when setting contributions
4. No time limitations (referred to as evergreen)
5. No onerous conditions attached that could compromise trustees or TPR powers
6. Legally enforceable in UK and any relevant overseas jurisdictions (supported by appropriate legal advice)
7. An information sharing protocol, which ensures trustees can monitor the strength of the guarantor

Working together on the new Funding Code



The role of covenant in scheme strategy



Risk underpin

Funding Buffer

Sponsor covenant

Contingent assets



Q&A

