At a glance

Ten key points about the employer covenant

1	The covenant is the extent of the employer's legal obligation and financial ability to support the scheme now and in the future.
2	Trustees should take investment and funding risks based on the ability of the employer to support the scheme. A sound understanding of the covenant is therefore an essential part of an integrated approach to risk management. Trustees should clearly document the assessment process and its conclusions.
3	Assessing and monitoring the covenant should be proportionate to the circumstances of the scheme and employer, including the degree of reliance of the scheme on the employer now and in the future and the complexity of the employer's operations.
4	Trustees should consider obtaining independent external advice where they lack the objectivity or expertise required to perform an appropriate assessment.
5	Trustees and employers should work openly and collaboratively together. A proportionate covenant assessment, aided by good information sharing, is in the employer's best interests so the scheme does not pose an unnecessary risk to its future sustainability.
6	The covenant assessment should focus on entities with a legal obligation to support the scheme. Trustees should be cautious about placing medium or long-term reliance on the continued support of entities without such an obligation. It may, however, be reasonable to rely on informal support in the short term where this has been given in the past and there are plans for this support to continue to be provided.
7	The strength of the covenant is relative to the scheme it supports. The covenant assessment should therefore focus on the support available from the employer in the context of the funding needs and investment risk of the scheme.
8	As well as assessing the strength of the current covenant, assessments should be forward-looking and focus on the ability of the employer to contribute cash to the scheme over an appropriate period to achieve and maintain full funding based on an assessment of the employer's forecast cash flows and the medium and long-term outlook for the business and the market in which it operates.

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9	If the employer's plans to invest in sustainable growth restrict the funding available to the scheme, trustees should understand how the scheme will benefit by supporting this investment and whether other stakeholders are contributing appropriately.
10	The covenant can change quickly. Trustees should monitor the covenant regularly between valuations and have well-developed contingency plans so they can take decisive action if and when required.

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