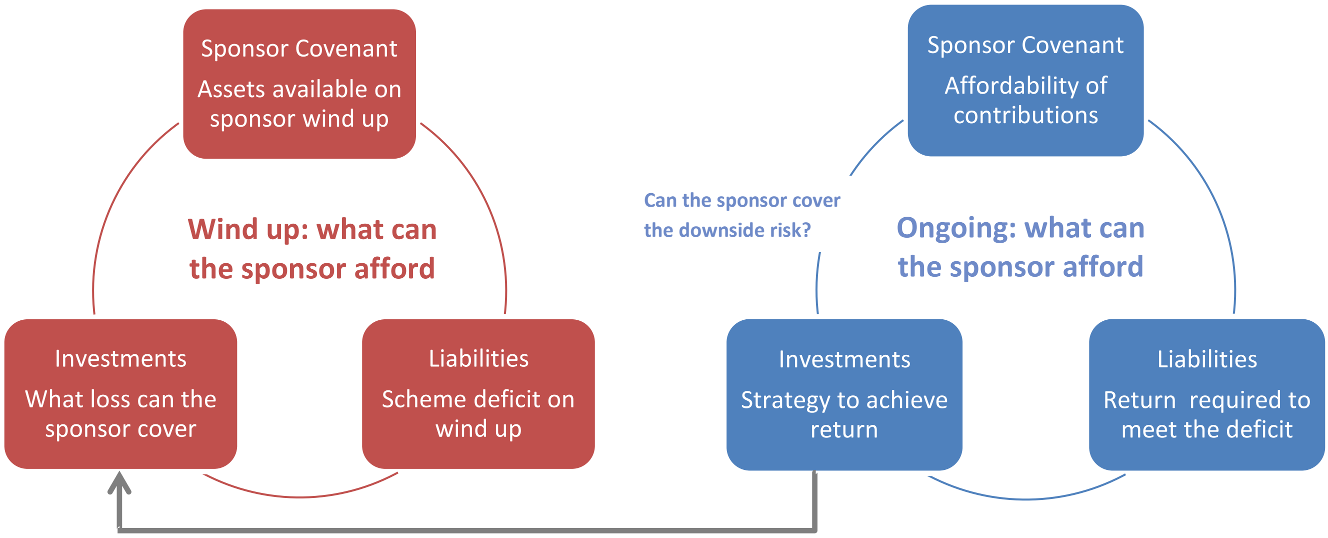
The thought process: The Trustees have to consider two related processes which both start and end with the sponsor covenant.



The key to working through this process is for all parties to work together; the Sponsor needs to see the Trustees as effectively owning a stake in the business and the Trustees need to understand the importance of having a strong, supportive employer.

From a Trustee perspective, it is important that money does not leave the sponsoring employer, for instance through dividend payments or trading losses or that more debt is accrued at a higher priority than the scheme, such as bond issues or bank overdrafts.

By working together the Sponsor and Trustees can agree a comprehensive and sensible funding plan (and investment strategy) that best meets their needs, for instance:

- Agreeing a recovery plan that takes into account the ability of the sponsor to make regular contributions and their ability to make additional contributions in the event of adverse experience
- The Scheme can invest in assets that mitigate some of the risks they might be running due to the sponsor covenant, for instance avoiding investing in commercial property if the sponsor is a retailer
- Manage liquidity to ensure that disinvestments are not made when markets are at all time lows

Sponsor Covenant: The key here is that the Sponsor/Trustees/Scheme Actuary work through a structured process to evaluate the covenant from the scheme perspective rather than obtain an expensive independent review or the sponsor carries out a review in isolation.

As a more bespoke exercise the Trustees should end up with a thorough understanding of the covenant and can therefore better take it into account in the funding discussions rather just adding margins for prudence. If the process is properly documented there will also be an audit trail available to present to the Pensions Regulator.

The Pensions Regulator has been given a new objective to take account of the sustainable growth plans of the sponsoring employer. This can easily be brought into the analysis above.

Liabilities: This is the most minor part of any valuation process. All parties should focus on what is affordable rather than tweaking the assumptions one way or another, which will usually only change the length of the recovery plan.

Investments: The investment strategy should be set based upon the returns required to meet the deficit (taking into account any prudence) and the ability of the sponsor to make up any investment losses (either on an ongoing basis through higher deficit contributions or on a wind up basis).

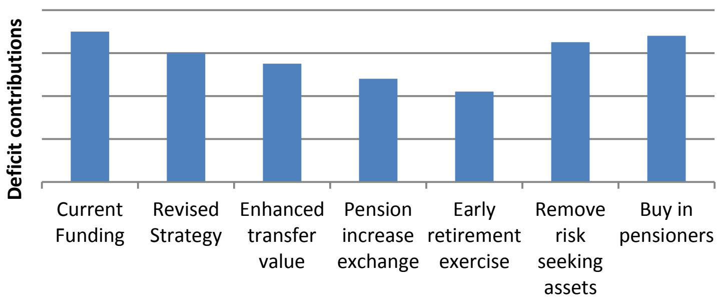
The proposed strategy should be properly stress tested using a model that captures the impact on both the liabilities and the sponsor. Particular attention should be paid to the asset allocation (which has historically had the most impact on the level of returns) and any unrewarded risks (in particular the inflation rate and interest rate risk).

As closed schemes mature and become net dis-investors rather than investors they need to start focussing on the medium term rather than relying upon long term out performance. In particular, they should be looking at getting the timing of the switch from risk seeking into matching assets right and, in these turbulent times, be much more actively monitoring their strategy to ensure that it remains suitable. Even for smaller schemes, it is possible to significantly reduce the risk through diversification and active management of the asset allocation.

Recovery Plan: Typically these were assessed against the length of the current recovery plan and those used by other schemes, subject to a "cap" of 10 years. However, the Pensions Regulator has responded to the recent crisis by taking a more tolerant view to extending the recovery plan. There are also alternatives:

Type	Description	Protection	Allowable for PPF levy
Negative Pledge	Sponsor promises to hold a certain level of unencumbered assets	On wind up	X
Parental Guarantee	Parent promises to meet any additional liabilities in wind up	On wind up	√
Contingent Asset (Property, cash, trademarks)	Charge over sponsor asset available on wind up	On wind up	√
Profit related contributions	Contributions include a share of the sponsor profits	Contributions	√
Investment related contributions	Contributions depend on investment performance	Contributions	√
Escrow account	Contributions held in separate account so can be refunded if surplus	Surplus	X
Asset backed contributions	Sponsor sets up an independent vehicle which provides an income stream to the scheme	Treated as an asset	√

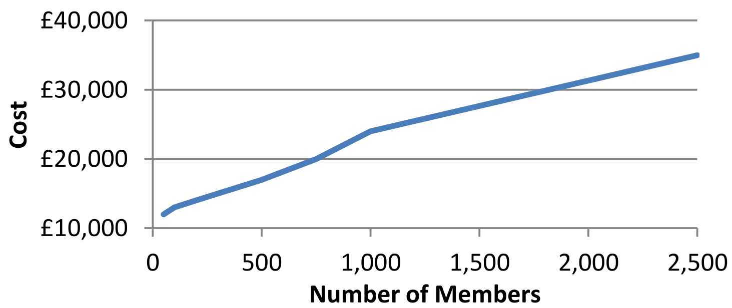
Fitting into the overall strategy: The recovery plan should fit into the overall strategy for the scheme.



The valuation is an opportunity for the Trustees and Sponsor to review the long term objectives for the scheme.

Even in the current environment, there are de-risking and liability management opportunities which, if done correctly, can benefit all parties.

Controlling Costs: As valuations get more complex costs can spiral. Schemes therefore need to understand what is covered and what isn't and ensure that all parties work collaboratively rather than from entrenched positions.



The chart shows what we believe is a reasonable cost for a typical scheme (1/3rd active/deferred/pension) based on number of members. To obtain a more accurate quote, please try out our fee estimator.

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