Streamlined Escrow for pensions

Given the regulatory direction of travel and the current economic environment, alternatives to traditional cash funding are rapidly increasing in popularity. LCP has been working with BNY Mellon and Travers Smith to provide you with a time and cost efficient way to set up an escrow for your pension scheme.

How our Streamlined Escrow could help you

Escrows are rapidly increasing in popularity, given their versatility – they can be an attractive option for both trustees and sponsors, as well as for both under-funded and well-funded schemes.

Some examples of how an escrow can be used to support a pension scheme include:

1. An escrow can be used to help bridge any gap between the trustee and employer views on funding assumptions or investment strategy. For example, the additional security provided could enable the scheme to take more investment risk, with the escrow funds being available to compensate the scheme if these risks don't bring the hoped for returns. At the same time, any upside returns could mean the sponsor can get its money back.

2. For well-funded schemes, an escrow can be used to help prevent "over-funding". This could mean avoiding a trapped surplus on wind-up, with the corresponding tax charge on a refund of surplus. Escrows are increasingly being used to manage these risks for full scheme buy-ins, where there is often an unknown deferred premium adjustment following a period of data cleanse. More generally, a sponsor may wish to aim for no more direct scheme contributions once a given funding level is reached.

3. In light of Covid-related market and covenant effects, the recent RPI reform announcements, and the effect of recent court cases on the Pension Protection Fund (PPF), there will be a renewed expectation of materially higher PPF levies for some schemes (despite the average levy falling). Certain PPF-approved contingent assets, including charged escrows, can be structured to help reduce the PPF levy and in some cases will now yield much bigger levy savings than before.

Our streamlined escrow provides the following advantages for sponsors and trustees over approaching the open market directly:

1. Quick and efficient set-up: the pre-designed contract helps you get a competitive deal without the lengthy and costly negotiations that would be required to secure similar terms in the open market.

2. Certainty on fees: the one-off fixed set-up fee includes all initial set-up costs with the escrow agent BNY Mellon.

3. Flexibility: there are no minimum or maximum contributions, or limits on the number of contributions or withdrawals you can make to the escrow. You can choose whether to invest the escrow assets in cash or one of several well-known money market funds.

How our Streamlined Escrow helped World Duty Free Group reduce cash contributions to its pension scheme while providing additional security to members.

Background

We advise the sponsor who is a leading player in the travel and retail industry. The pension scheme, which has c £170m of assets, was projected to be fully funded on the existing technical provisions basis. But as a result of Covid-19, the short-term covenant was significantly impacted at the valuation date of April 2020.

The Trustee wanted to add a degree of prudence into the valuation assumptions to account for the covenant deterioration. This led to a proposal that increased the headline deficit significantly.

However, the sponsor was confident that the weakening of the covenant assessment was temporary, and that once travel restrictions were lifted the business would bounce back. So they didn't want to use precious cash resources to fund the pension scheme if that was likely to lead to a large surplus at the next valuation by which time the covenant was expected to have improved.

Solution

Market conditions and investment performance improved the position of the scheme by spring 2021, and this was reflected in an agreed much reduced deficit.

A five-year recovery plan was agreed for this deficit, with the annual deficit contributions initially being paid into an escrow rather than the scheme. If, at the next valuation in 2023, the business has bounced back as expected, then the funds in escrow will be returned to the sponsor. On the other hand, if the covenant has not recovered, the escrow funds will be transferred to the pension scheme.

LCP's Streamlined Escrow was the ideal solution for the sponsor who wanted a cost efficient and simple process.

A key part of the Streamlined Escrow is the "tripartite agreement" between sponsor, trustees and escrow provider. This has been developed by LCP, legal firm Travers Smith and escrow provider BNYM. A significant amount of time and cost is saved by the existence of this document which provides a fair balance between the three parties and generally should not need much negotiation.

In this case, Travers Smith were also appointed by the sponsor to draft the "bilateral agreement" (between sponsor and trustee, agreeing the escrow/scheme funding triggers and how this links to the valuation – a straightforward document reflecting the substance of the valuation outcome) and the "security agreement" (the sponsor agreed, in this case, a "bolts and braces" approach to security by providing a charge over the escrow, which is an optional feature). As Travers Smith had already designed the legal aspects of the streamlined approach, this was particularly time and fee efficient. LCP also provided advice on the investment of the escrow funds.

Bilateral agreement

- Agreement between Trustee and Sponsor
- Formalises when and how much is paid into the escrow and the triggers that determine when the funds are paid into the pension scheme or returned to the sponsor

Security agreement

- OPTIONAL
- Grants a charge over the escrow in favour of the Trustee
- Needs to be written using the PPF's standard wording if levy savings are sought, but other options are available

Tripartite agreement

- Agreement between BNYM, Trustee and Sponsor
- Determines how escrow funds are invested and held; procedures for fund transfers; instruction process; escrow bank authorisations; information and disclosure; and the rights, duties and limitations of the escrow bank

→ *Streamlined Escrow*

Want to find out more?

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