

### Deal-making set to continue despite headwind



#### **Macroeconomic headwinds, compounded by the invasion of Ukraine by Russia, have led to more caution in the M&A market, both in the UK and globally.**

The conflict has already halted some prospective deals and slowed others in the earlier stages. It has also prompted some acquirers, particularly those looking at targets in Europe, to conduct additional due diligence or question whether transactions are worth the legal or financial risk. Inflationary pressures and the likely increase in interest rates (which may impact leverage capacity) add further market pressure.

Notwithstanding this, it is expected that levels of corporate activity will remain robust during 2022, with private equity firms seeking to deploy record levels of 'dry powder'.

Furthermore, we could see an increase in internal corporate activity as efficiencies are sought to help offset inflationary cost pressures. Together with robust deal-making activity and the introduction of the Pension Schemes Act 2021 (PSA 2021), this means that trustees will have to scrutinise events which could materially alter a pension scheme's covenant.

When assessing corporate events, there are a number of points for trustees to consider, including:

1. The strategic benefits of the transaction, together with the risks it introduces;
2. The impact on a sponsor's capital structure (including increased debt and use of proceeds);

3. Value leakage in the form of, among other things, reduced profitability, dividends and intra-group movements either as part of the deal or post-deal;

4. Movements of assets in and out of sponsors post-deal. For example, in the case of an acquisition, the acquirer may seek to streamline operations post-transaction; and

5. The potential triggering of a section 75 debt and/or impacts on trustee powers under a scheme's trust deed and rules (e.g. wind-up powers)

In the post-PSA 2021 world, it is important for trustees to demonstrate how they have proactively evaluated the covenant impact of corporate activity (even where the covenant is strong) to meet regulatory obligations and help facilitate an outcome that benefits all stakeholders.

Often the issues faced by a pension scheme as a result of a transaction can be overcome through innovative mitigation packages and suggested changes in transaction structures to benefit the pension scheme. Cardano's Pensions Structured Solutions can help navigate these challenges and wrap mitigation into a scheme's broader risk management and journey plan framework.



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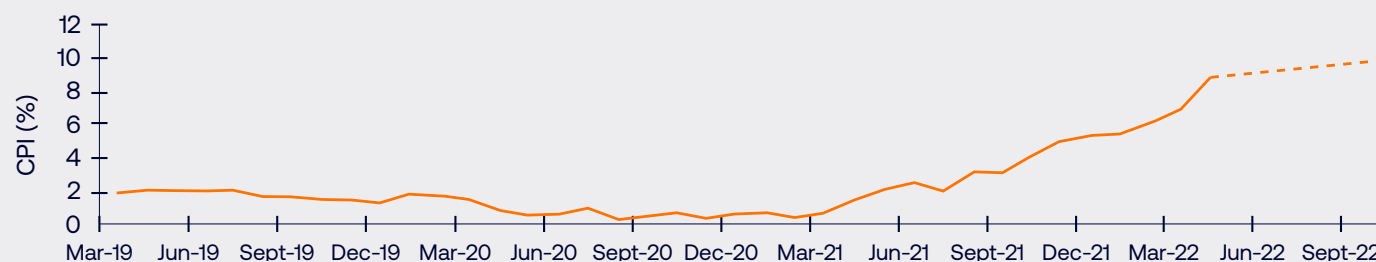
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## Datawatch: UK inflation reaches 40 year high

UK inflation reached a 40-year high in the year to April 2022 (9%) and is expected to rise above 10% in the autumn. As central banks begin to increase borrowing costs in an attempt to curb this impact, market commentators are increasingly expectant of a recession. Trustees should be cognisant of the impact that rising costs could have on their sponsors

(as well as pension scheme liabilities), particularly in sectors where cost increases aren't able to be passed on to customers. To enable effective decision making, Trustees should maintain a close dialogue with their sponsor to understand how their financial outlook has been impacted and consider whether scheme funding or investment strategy should be altered as a result.

### ONS 12-month Consumer Price Inflation (CPI) rates and future inflation expectations<sup>1</sup>



Note: (1) Future inflation expectations are based on Bank of England estimates that inflation will peak at 10% in autumn

## Ask the Analyst:

### What do trustees need to think about when determining an end-game strategy?

End-game strategy is likely to be the natural focus for trustees and sponsors with more mature and well-funded schemes. Whilst being in a place to determine an end-game strategy may feel like a fortunate position for trustees and sponsors to be, it does not come without its challenges: volatile investment markets, changing insurer pricing, regulatory regime changes, covenant disruption, and a host of new end-game products will all be at the forefront of any end-game decision-making process.

To minimise the risk of roadblocks throughout the process, trustees and sponsors should: (1) set clear goals such that both parties are satisfied with the outcome; (2) assess the lay of the land to see what established or nascent end-game products are best aligned with their strategic objectives; (3) set a timeline; and (4) stick to it!



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## Regulatory developments: TPR's 2022 Annual Funding Statement (AFS)

The AFS laid out TPR's expectations of trustees and sponsors for the year ahead.

- 1. Covenant challenges at the forefront** – Amidst the current macro-economic uncertainty, trustees are reminded that engagement with the sponsor to understand covenant implications is key.
- 2. Trustees need to be mindful of long-term reliance on covenant** – As many schemes reach full funding on a technical provisions basis, trustees are encouraged to focus on long-term covenant risks and work to reduce reliance on covenant over time.
- 3. Integrated risk management (IRM) remains a key focus** – Material risks can be correlated and scenario planning is a useful tool for IRM, enabling trustees to consider covenant and funding impacts of plausible downside scenarios.

The AFS encourages trustees to focus on covenant, including current challenges and longer-term risks. Robust risk management and long-term planning are, as always, essential.

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