

Common Signs of Employer Stress and Distress

What Is Stress?

Internal or external factors that put pressure on a business, and/or mean that it is not performing or operating as well as it should be.

What Is Distress?

Internal or external factors that mean the viability of some or all the business is threatened.

What Do Pension Trustees Need to Know?

A failure to recognise and address stress in a business may lead to distress. A failure to recognise and manage distress will often result in either business failure or serious value dilution for key stakeholders, such as the employer's pension scheme.

While many of the signs of stress or distress will comprise of information that is only available to the sponsor's management team, it is good practice for pension trustees to understand the signs, and to put in place tools that will help them to monitor and identify these signs at an early stage, so far as possible. This will allow trustees to put a plan in place so they can react quickly, and take appropriate advice, in the event of employer stress or distress.

What Are the Key Signs?

In order to aid trustee understanding, the table below describes some generic key signs of stress or distress in a business.

	Signs of Stress	Signs of Distress
Customer, supplier and creditor relations	<ul style="list-style-type: none"> • Margins on supply contracts becoming tighter • Supplier tightening payment/protection terms (such as retention of title) • Credit insurance is difficult to find, or it is becoming more difficult or expensive to increase cover • Key suppliers falling behind with deliveries, or decreases in quality of goods, will impact the performance of the business • Disputes with landlords, suppliers or creditors • Customers seeking greater visibility of financial performance before placing an order • Supply chain disruption creating pressure on funding and performance • Overreliance on individual projects, customers, suppliers or contracts • Unplanned-for increase in stock levels • Demand for goods and/or services slowing within the market generally 	<ul style="list-style-type: none"> • Loss of key supplier or customer • Receiving letters of demand, court proceedings, unpaid judgments, statutory demands and/or winding up petitions • Suppliers put the business "on stop" • Credit insurers withdraw cover • Customers are demanding performance bonds • Contracts are being placed elsewhere

	Signs of Stress	Signs of Distress
Corporate activity	<ul style="list-style-type: none"> Plans for acquisitions are delayed, or shelved due to uncertainty Disposals are taking longer than anticipated Rebranding or expansion into different sectors may cause margins to be stretched too thinly Refinancing terms are more expensive than expected, or require more security Growth is still pursued, but there is recognition of the need to self-fund 	<ul style="list-style-type: none"> Financing has failed or is significantly delayed New borrowings are unavailable Disposals of parts of the business or assets are contemplated to free up cash or eliminate losses
Management	<ul style="list-style-type: none"> There is a difficulty in attracting new senior management 	<ul style="list-style-type: none"> Sudden focus on cash and cost rather than growth Looking to borrow additional funds to plug cash flow gaps Significant and quick changes in senior management and/or at board level Loss of key employees Numerous or irresolvable disputes at board level
Performance	<ul style="list-style-type: none"> Borrowing margins are becoming tighter and headroom in facilities is squeezed HM Revenue and Customs (HMRC) debt is increasing Profitability, within the business or specific departments, has fallen or has not grown in line with forecasts Top line growth, which was previously consistent, has plateaued A material increase in borrowing is forecast Emergence of a strong competitor Market conditions are worsening There are sector-specific challenges in the market the business operates in Exchange rate inflation Raw material and/or production cost inflation Inability to pass on increasing costs to customers Increasing overhead costs without a corresponding increase in revenue Business model challenged by technological advances 	<ul style="list-style-type: none"> Borrowing facilities have been (or are expected to be) exceeded Cash flow has become tight Credit terms exceeded Taking longer than usual to pay suppliers Business is (or is expected to be) in breach of loan covenants HMRC Time to Pay arrangements have been utilised Revenue is falling, even though there is growth elsewhere within the market or sector Earnings before interest, tax and amortisation (EBITA) is insufficient to fund interest, investment or financial commitments There are acute supply chain problems, e.g. key supplier failure Significant hikes in prices, e.g. raw materials or energy, that aren't hedged or otherwise budgeted for Subsidiary company significantly underperforming or loss-making

	Signs of Stress	Signs of Distress
Lender attitude	<ul style="list-style-type: none"> • Lenders are requiring a greater level of information • Agreed lender forbearance due to end • Existing lenders signal an unwillingness to increase their exposure • Lenders appoint specialists to oversee credit issues alongside relationship bankers • Higher interest payments 	<ul style="list-style-type: none"> • Lenders are requesting the appointment of reporting accountants, or reporting accountants are appointed • Existing lenders are restricting the use or availability of funds, or refusing to advance further monies • Management of the company's account has been transferred to a specialist unit within the lender • Loans are being marketed to or have transferred to alternative capital providers • New borrowings are unavailable
Communications	<ul style="list-style-type: none"> • Profit warnings • Accounting reference date is changed • Management are downplaying growth expectations • Customer/end-user complaints or disputes 	<ul style="list-style-type: none"> • Two or more profit warnings • Delays to announcements in relation to results • Delays in filing accounts • Significant uptick in adverse social media reports
Other issues	<ul style="list-style-type: none"> • Staff shortages • Lack of investment in new technologies • Doubts over the efficacy of accounting policies 	<ul style="list-style-type: none"> • There is an accounting "black hole" • Fraud • There is a large pension deficit • Creditor demands for payment

How Can You Stress Test Your Sponsor?

Trustees have a duty to monitor the strength of the employer covenant. The Pensions Regulator (TPR) provides detailed [guidance](#) to assist trustees.

While many of the signs in the table above will be difficult for trustees to spot in the ordinary course of events without specific information from the sponsor, the list below sets out high-level indicators that trustees should be able to identify at an early stage, enabling them to take appropriate action.

- **Late/missed pension contributions.**
- **Change in behaviours/conduct** – This could be anything, but noticeable changes in how a sponsor engages with the trustee board could flag underlying issues, for example failure to attend trustee meetings when a company representative would normally attend, late provision of information under an information sharing protocol or refusing consent to discretionary practices (for example, ill health early retirements) that the sponsor would historically waive through as a matter of course.
- **Economic conditions/sector challenges/political events** – External factors impact the viability of all businesses. How do these affect your sponsor? Are they particularly reliant on a country that is now in turmoil, blacklisted or affected by sector issues, (e.g. the availability of raw materials)? Will increased tariffs or inflationary rises "stress" your sponsor?
- **Credit checks** – By running regular credit checks, you can keep track of your sponsor's credit rating and whether it is deteriorating. There are many external providers who offer this service.
- **Financial information** – What do the records at Companies House say? Are accounts being filed late? Consider the wider group position: Is there an underperforming subsidiary or loss-making division that may impact the performance of your sponsor? What is the intercompany debt position?
- **News/social media reports** – Keep an eye on what is being reported. Reports may reveal whether your sponsor is involved in a contentious dispute or other financial difficulty or is in acquisition talks. Further, if there is a lot of bad press about your sponsor, this might indicate that all is not well, financially.

Some Practical Points

Do	Don't
<p>Do put in place a monitoring framework, which includes identifying key covenant support risks with performance indicators for those risks (much like a risk register).</p> <p>Decide in advance the possible actions that will be taken if a performance indicator is breached, for example seeking a meeting with the employer, or additional contributions or contingent asset support/security. In serious situations, trustees may wish to seek an out of cycle valuation.</p> <p>TPR sets out more information in the monitoring section of its covenant guidance.</p>	<p>Don't be a stranger! Keep communication channels open with the employer. Ask the sponsor to nominate one person in senior management who will act as a key contact for the trustee board and be available to share information and discuss company progress on an <i>ad hoc</i> basis outside of formal presentations and meetings.</p> <p>TPR says that "a good working relationship with management to support clear and open communications is key to any monitoring".</p>
<p>Do put in place (or update existing) information sharing agreements and be sure to include any areas of particular concern identified from the key signs table above.</p>	<p>Don't delay in appointing covenant advisers. Most trustee boards will not have the skill set necessary to monitor the employer covenant on a regular basis and will instruct covenant advisers to do this on at least an annual basis. Covenant advisers could also be instructed to monitor and report on any red flag activity as soon as it happens, such as a fall in the sponsor's credit rating, or the late filing of accounts at Companies House.</p>
<p>Do request that financial presentations by company representatives at trustee meetings highlight and address any of the key signs of stress or distress that the trustees have identified as being of particular concern and/or relevance in the context of the sponsor's business.</p>	
<p>Do consider whether the scheme could take security over the employer's assets and/or improve existing security packages.</p>	<p>Don't leave it too late to check the validity/ veracity of the scheme's existing security and take advice – the sooner the trustees can fully understand the security position, the better, as they will likely have more options.</p>

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