Dalriada Trustees – Industry Changes

Your Quarterly Pensions Update

October 2016

Dalriada. A better way

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INTRODUCTION

The purpose of this report is to update sponsors and trustees with recent pensions industry changes, up to the end of September 2016.

For your convenience Dalriada Trustees Limited (Dalriada) has summarised the key developments and highlighted the necessary actions sponsors and trustees may need to take.

The format combines brief written comment with links to any further relevant information and any deadlines you should be aware of.

We trust you will find the update useful and informative. If you require further information about how any of the topics covered might impact on your scheme specifically, please get in touch with your usual Dalriada contact.

NOTE

This document is aimed at providing you with generic information about recent developments in the pensions industry.

You should not take any action as a result of information included in this document without seeking specific advice in relation to the impact these matters might have on your scheme or company. Dalriada accepts no liability for actions taken or not taken as a result of this document.

BREXIT: 5 INVESTMENT QUESTIONS TO CONSIDER

Tags: Brexit Investment Funding

The UK has made its choice, and has voted to leave the EU. What does that mean today for your occupational pension scheme?

In the wake of the result on 23 June 2016, significant market volatility ensued. With the yields on UK Government bonds falling considerably, the majority of schemes will have experienced an increase in liabilities. However, the impact on funding will also depend on your scheme's investment strategy.

We therefore posed some of the questions which you may want answered to our own Chief Investment Officer, Simon Cohen.

1. Should my Scheme's investment strategy be altered?

The vast majority of pension schemes are long-term investors, and as such trustees should take the time to consider their investments rather than reacting immediately to short-term volatility. However, that said, trustees should be asking themselves whether their investment strategy is still suitable and if it is not, they should be amending it accordingly.

2. What if I am currently undergoing an investment transition?

The market volatility as a result of Brexit should not alter the objectives of any investment transition. However, trustees may wish to review certain practicalities of an investment switch. For example, it may be best to spread asset transitions over a series of trades to avoid any further market volatility (if the trades are large enough). In addition, there may be more opportune times than others to actually trade. Once the decision to trade has been made, this should be implemented as soon as possible, as market conditions can quickly change. Trustees might also want to think about using trigger based strategies to implement the changes.

3. Should I hedge against interest rate/inflation risks?

Schemes with leveraged liability driven investments ("LLDI") may have seen their funding positions better protected than those that don't, as interest rates have fallen significantly post Brexit. Trustees may be thinking that yields cannot go any lower so why hedge at such a low

level. In fact, yields have gone lower following the Bank of England's recent stimulus announcement in August, and they could go even lower - just look at Japan!

In addition, any Trustees implementing LLDI will be locking into the yield increases currently implied by the markets. To be calling interest rate levels trustees need to be confident that yields will rise more than currently implied by the markets.

4. Do I need to review my Scheme's currency hedges?

One clear message from Brexit has been that currency can be very volatile. Those that hedged currency risk will have missed out on the benefit from the significant falls in Sterling on their overseas asset holdings. I would not like to predict in the short-term what level sterling will reach and whether it is currently over or under-valued. Given that view, trustees who were unhedged might want to consider putting on at least a 50% currency hedge.

5. Do I need to prepare for future economic shocks?

The markets remain very cautious. Volatility seems to have temporarily settled, but there is so much uncertainty around Brexit and the EU that an unexpected event, or even an expected event at an unexpected time, could trigger another shock in the market, causing further volatility. It cannot be predicted when the next market upset will occur, but with negotiations on the details of Brexit yet to begin and Article 50 yet to be triggered, the market is likely to remain uncertain for the foreseeable future. On top of that, there also global uncertainties, for example, the outcome of the US Presidential Election or whether China will continue to slow down. Given that context, trustees should prepare themselves for future shocks and have strategies in place to deal with them.

Helpful Links:

- Dalriada Blog – BREXIT is a reality

ACTION

Trustees should review their funding, covenant and investment strategy. The situation is evolving on a daily basis, therefore ongoing monitoring of events and of your scheme is crucial.
Scheme sponsors should ensure that they understand the investment strategy and how this ties in with their own objectives. Employers will want to ensure an appropriate governance structure is in place so that they can provide effective input into investment decisions.

BREXIT: TPR GUIDANCE STATEMENT ON MARKET VOLATILITY

Tags: TPR DB Funding

In July, the Pensions Regulator (TPR) issued its guidance statement on market volatility following the EU referendum. This was quite a wide ranging statement covering a number of areas.

The key message to Trustees and sponsors is to remain vigilant and review their circumstances, but continue to take a considered approach to action with a focus on the longer term.

It will be important to effectively communicate the Scheme's plan to members concerned about how the referendum will affect their pension.

DB Schemes

The regulator continued to assert the importance of taking an integrated approach to risk management, with a particular focus on contingency planning.

It will be important to monitor sponsor covenant, particularly if the sponsor's business has exposure to the EU in terms of currency and reliance on imports or exports.

The scheme's funding level may be very volatile over the coming period as it is affected by market conditions which will be adjusting to the referendum result. A lot of this volatility will be the result of short term market movements, this shouldn't affect the scheme's funding strategy, but may have an impact on liquidity and cash flow management.

Trustees should consider longer term views on expected risk and returns in line with their funding plans and risk appetite. If they feel they are exposed to an inappropriate level of risk, they should review this in an integrated context and carefully plan any actions that are needed.

Schemes currently undergoing a valuation should carry on as normal in terms of timescales. However, they may wish to consider carrying out more in depth sensitivity analysis and understand the resultant impact on the scheme's recovery plan. It may also be worth evaluating the contingencies in the funding plan and undertaking more regular monitoring of scheme funding, alongside covenant and investment.

DC Schemes

It is important to remain focused on long term investment aims and not make decisions based on short term events. Continue to monitor and review the performance of funds and act accordingly if it is felt that long term performance will be affected by the referendum.

Helpful Links:

- Guidance statement from TPR– Market volatility following the EU referendum
- Hugh Nolan's blog in Pensions Expert - The Brexit effect on schemes and stats
- Industry opinion - Our mad approach to pension-fund deficits

ACTION

Trustees should consider with their advisers the extent to which volatility and changing market conditions affect the longer-term view of expected risk and returns, and how this interacts with the scheme's funding plans and risk appetite.

If your Scheme is undergoing a funding valuation, make sure to take note of TPR's guidance statement.

Trustees should have an open and collaborative discussion with the employer to understand their views and position, along with the impact of this for their risk appetite in respect of the scheme.

BREXIT: EUROPEAN DEVELOPMENTS IN RISK ASSESSMENT FRAMEWORK

Tags: Brexit | Legislation | EIPOA

The European Insurance and Occupational Pensions Authority ("EIOPA") is endorsing the implementation of a common risk assessment and transparency framework across the European Union in the form of a holistic balance sheet ("HBS"). This idea was contained in the initial proposal for a solvency requirement in earlier IORP II drafts before being shelved. The HBS would consider the pension scheme's funding with reference to investment risk and return, sponsor covenant and funding position.

There is the possibility that TPR could enforce the idea of the HBS independently to apply to the UK post Brexit, albeit without the assistance of EIOPA. However, should the UK remain a member of the European Economic Area and elect to abide by single-market financial legislation, then EIOPA's version of the HBS could potentially apply to UK pension schemes through future IORP directives.

Also, TPR has been supporting the concept of Integrated Risk Management ("IRM") and has issued guidance in relation to this. Given the similarities between IRM and IORP II in terms of risk management and governance, it is unlikely that the UK will escape these additional regulatory obligations going forward.

It should be noted that any previous EU directives embedded into UK law will remain so, unless there is a radical overhaul of legislation post Brexit. Instead, Brexit could give the Government additional flexibility over time to amend those laws stemming from EU legislation.

Helpful Links:

- Spence and Partners Blog – Nothing Holistic About Brexit

ACTION

Trustees should continue to assess their risk management options and monitor their defined benefit pension schemes deficits closely given the recent turmoil in the financial markets. They should also keep up to date with their regulatory requirements and how these might change once Article 50 is invoked and subsequently when the UK officially leaves the EU.

BREXIT TRANSFER VALUES

Tags: Brexit Transfer Values

It was difficult to predict the detrimental impact on gilt yields that occurred in the weeks following Brexit, to say the least! With gilt yields plummeting below already historically low rates, pension schemes are now faced with significantly higher liabilities. Transfer values ("TVs") for deferred members of DB schemes also increased, as these too are generally calculated with reference to gilt yields. So, trustees may now be concerned with their scheme experiencing an increase in TV requests.

Trustees are ultimately responsible for the security of benefits of ALL members – those who wish to transfer and those who remain in the scheme. At this time, when pension schemes are battling increasing deficits, paying out large TVs could have a serious impact on the security of benefits for those members who remain in the scheme, especially if TVs do not reflect underfunding in the scheme. Trustees may therefore wish to consider reducing TVs to reflect any underfunding.

As TVs are calculated on a 'best estimate' basis, schemes may see an improvement in their ongoing and solvency funding levels as liabilities on those measures are assessed more prudently. Some employers may also see an improvement in their accounting position. Employers may even consider incentive exercises which encourage members to transfer out in an attempt to manage liabilities. Of course employers should consult with the trustees in such cases and the Code of Good Practice for Incentivised Exercises should be referred to.

Deferred members who are aware of the impact current market conditions have on their benefits may be more inclined to request a TV now and take advantage of the higher amounts payable. Members are encouraged to take Independent Financial Advice (and in certain circumstances are obliged to) before deciding whether or not to transfer out of their DB scheme. Although higher TVs will be attractive to some members, this does not automatically mean it is in a member's best interest to transfer out.

ACTION

Trustees should monitor transfer activity on their schemes. If activity increases, then trustees should ensure they have sufficient liquid assets to settle the transfers, remembering that any TVs greater than 5% of scheme assets are a notifiable event to the TPR. They should also consider whether it would be appropriate to commission an insufficiency report if underfunded, in order to protect to security for members who do not transfer.

If they don't already do so, trustees should consider notifying members of their transfer values as a "business as usual" process e.g. with any retirement quotations, so that members have full information about the value of their benefits.

Employers should consider the attractiveness of a liability management exercise, as the cost of incentivising members to transfer may have fallen as a result of higher TVs.

INTEREST RATE CHANGES & EFFECT ON FUNDING LEVEL

Tags: TPR | Risk Management | DB Scheme Funding

The Bank of England ("BoE") announced in early August that it had cut its base interest rate to a historic low of 0.25% p.a. On the face of it, ultra low interest rates can be a blessing for those currently borrowing. But what effect will they have on the funding level of your pension scheme?

A scheme's liabilities are often discounted with reference to a gilt yield, such as the 20 Year UK Gilt yield. There is a 'see-saw' relationship between the discount rate used and the value of the scheme's liabilities; a decrease in the discount rate will result in a higher valuation of the liabilities. With this in mind, the 20 Year UK Gilt yield fell from 1.48% p.a. to 1.31% p.a. as a result of the BoE's announcement. This meant that, on the day the BoE cut its base rate, a typical scheme could have seen its liabilities increase by around 4% alone. Remember, this comes on the back of the gilt yield shock that followed Brexit.

So that is the effect on scheme liabilities. But what effect has there been on the value of scheme assets? In theory, lowering borrowing costs should boost trade activity and improve the value of UK based companies. For example, the FTSE100 index increased by over 4% in the week following the base rate cut. It is natural, then, to expect the value of a scheme's assets to have increased if the scheme holds equities in its asset portfolio.

The BoE also announced that the UK's quantitative easing programme is to be extended, with an additional £60bn to be pumped into the economy through the purchase of government bonds. This should have a similar effect on schemes who invest in equities, helping to offset some of the funding level deterioration caused by higher liabilities.

ACTION

Continue to monitor market movements, particularly in relation to Brexit and take an integrated approach to risk management.

Negative Interest Rates

Tags: BOE Base Rate | Funding

With the likelihood of a zero percent base rate increasingly likely in the Bank of England's ("BoE") next review in November (in September they said a majority would support such a move if economic forecasts didn't improve), there is a very real possibility of the UK joining the growing club of major states with negative base interest rates in the not too distant future.

In terms of pension schemes themselves, this won't be an unexpected shock – they have been feeling the pain on their funding levels for a number of years with the low interest rate environment. Putting a '–' in front of the base rate isn't going to shock schemes who have been seeing the number behind the '–' in their funding results growing year on year.

However, the group that could be shocked are savers, and in particular, pensioners. In July, Ros Altmann reacted to the news that Natwest had warned corporate customers that they may have to charge interest on accounts in credit if the BoE dips the interest rate into the sub-zero waters. Should that happen, many will anxiously wait to see if those charges seep across to personal savings accounts too.

In truth, pensioners have been feeling the pain of low interest rates for some time now, right across Europe. Despite showing real patience – or perhaps acquiescence – with little to no returns, surely those same people would jump into action if their savings actually started to shrink. Even Commerzbank in Germany are reportedly considering shifting billions of euros to their vaults, rather than pay for the ECB to hold it under its negative rates.

While it may be reasonable to follow the actions of a big bank with its hundreds of financial advisors, the typical pensioner is different – they don't have a vault. Should pensioners take such action, there have to be real security fears for their savings, as well as their own health and safety. Beyond the concerns of large amounts of cash being under beds, there is also the real possibility that these concerned pensioners may be more susceptible to pension/investment scams, offering a safe haven with positive returns on their savings. Should negative interest rates come our way, the industry should be alive to these risks arising.

Helpful Links:

- BoE Monetary Policy Decision – September 2016
- Dalriada Blog – That's Interest-ing

ACTION

Continue to monitor market movements, particularly in relation to Brexit and take an integrated approach to risk management.

VAT for Pension Schemes

Tags: VAT Governance

On 5 September HMRC extended the transitional period to deal with the issue of applying VAT to pension scheme services from 31 December 2016 to 31 December 2017, whilst opening the door to a further extension if HMRC feel it is necessary.

In the past, HMRC allowed employers to recover VAT on invoices for professional fees which were incurred by the trustees (but invoiced to the Employer) in relation to the administration of the scheme. On the flip side, HMRC did not allow employers to recover VAT on investment management fees in the same way except where fees were covered by "mixed" invoices.

Two CJEU cases in 2014 (the PPG case and the ATP Pension Service case) changed the landscape, resulting in HMRC accepting that it was possible for an employer to recover VAT on administration fees provided certain conditions were met. There were potential solutions including tripartite agreements (but there were corporation tax issues), VAT Grouping (but with concerns about joint and several liabilities) or trustees registering for VAT.

Whilst HMRC mulled over a solution they introduced a transitional period that allowed trustees and employers to operate under existing provisions, i.e. employers continued to recover a proportion of the VAT on management costs under bilateral agreements where the trustees meet the cost. This was originally until 31 December 2015 but that has now been extended to 31 December 2017 (and possibly beyond?).

If it has not already been considered then the issue should be on the agenda of trustee meetings, for trustees and employers to consider, identify fees that might be in scope and to consider what action they should take in relation to transitional provisions and the alternatives (noting the potential problems). There is no 'one size fits all' solution and all come with some issues and practical changes that need to be addressed in order to implement them

Helpful Links:

- HMRC Brief 14 - 5 September 2016
- Dalriada Blog - Even HMRC have a too hard to do pile

ACTION

Other solutions may emerge but we would recommend that trustees and employers commence discussions now, taking appropriate VAT advice, in order to ensure sufficient time to go through all the necessary steps. It certainly may be financially beneficial in the long run for schemes.

THE TRIPLE LOCK STATE PENSION

Tags: State Pension | Triple Lock

Earlier in the quarter, Baroness Altmann (former Pensions Minister in the Cameron Government) voiced her opinion that the triple lock State Pension would not be affordable after 2020. Since its introduction in 2010, the Basic State Pension has been locked into increasing each April by the greater of Inflation, Average Earnings, or 2.5%.

What Baroness Altmann proposed is that the triple lock should end in 2020 and be replaced by a double lock, with the 2.5% guarantee falling away. Her proposal actually wouldn't have had any effect in April this year, as earnings increased by 2.9%. This was compared to inflation last year of -0.1%. However, given that in 2014 inflation and earnings were much lower than 2.5%, the 2.5% guarantee had a considerable effect that year.

What many experts fear is that if the UK was to go into a period of prolonged low (or even negative) inflation and wage inflation, the situation would arise where other pensions would only marginally increase (if at all), and the same would apply to the average person's wages. At the same time pensioners would see a 2.5% increase to their income. So moving to a double lock would clearly be deeply unpopular with pensioners.

However, a report last year from the Government Actuary's Department estimated that the triple lock already cost in the region of £6bn a year and that these costs could spiral going forward. So you can see the Government's dilemma: How to save money while not losing the powerful pensioner vote.

There is no consensus on this dilemma. Baroness Altmann's predecessor, Steve Webb stated that the triple lock should remain, saying it was an important way of building up a State Pension that been neglected. However, other prominent players in the pensions world, such as the Institute for Fiscal Studies (IFS), have said the triple lock is simply unaffordable.

The Government has promised to maintain the triple lock until 2020, but what will happen after that? Whoever may be in charge in Westminster, they could chose to keep the triple lock, remove it entirely, go with the proposed double lock, or even amend it by reducing the 2.5% guarantee.

Whatever happens, it will be interesting to see what decisions are made. With the costs mentioned and the pensioner population growing and growing, a decision will have to be made on this one!

THE REGULATOR'S ANNUAL FUNDING UPDATE

Tags: Annual Funding Update | Gilt Yields | Market Conditions

The Pensions Regulator published its annual funding update in May 2016. As the bulk of valuations are either December or March/April it gives trustees a flavour of what the Regulator expects from them; a sort of summary of the Regulator's take on market conditions, actuarial assumptions and current thinking. In broad terms whilst investment performance has been strong (approx. plus 25% over the last three years), gilt yields have continued to fall, and as a result deficits have increased by between 20% and 35% over the last three years.

The Regulator's analysis of sponsoring employers suggests that if a scheme chooses to maintain their existing recovery period end date following their valuation, then the median increase in deficit repair contributions ("DRCs") is expected to be in the region of 75 to 100%! This may or may not be affordable to sponsors and will depend on a number of factors, such as the sponsor's future plans. However the Regulator expects trustees to seek higher contributions where there is sufficient employer affordability.

Worryingly, around 45-50% of schemes are expected to need to increase DRCs by more than 100% in order to keep the same recovery plan end date. Where the current recovery plan period can not be maintained, other adjustments will be required in order to put an appropriate recovery plan in place; for example by extending the recovery plan length. Again, trustees need to consider the potential impact of taking on this additional risk.

The Regulator also pointed out that the ratio of DRCs to dividends has dropped from 17% to 10% over the past six years. Keeping recovery plans the same will require this ratio to increase up to 13%. This is still below where we were three years ago, hence the sharp recovery period increase in required contributions could, they argue, be affordable.

Helpful Links:

- TPR Annual Funding Statement

ACTION

Trustees and Sponsors need to establish what is affordable in their particular situation. They should consider this in the framework of integrated risk management – looking at all aspects of funding, investment and covenant together, as the three are all interlinked.

ANNUAL REPORT OF THE PENSIONS OMBUDSMAN

Tags: Pensions Ombudsman

The Pensions Ombudsman's ("TPO") Annual Report for 2015/16 was published in July and made for a glowing endorsement of the new procedures that the new Ombudsman, Anthony Arter, had implemented since taking over in 2015.

Despite receiving a greater number of initial complaints (an 18% increase in fact), and committing to 6% more investigations from those than during 2014/15, TPO managed to increase its completion rate by 35% from the previous year. The increase in complaints was anticipated (primarily due to pension freedoms, SIPPs and the prevalence of pensions liberation) but the approach that Mr Arter put in place has managed to deal with the swell of grievances.

The core reason for the impressive completion rate has been the new focus on a "more direct and personal approach", whereby cases are triaged in accordance with complexity and delegated to focused teams within the PO, who now have the power to promote early dialogue and find an informal resolution. The staff who were previously called "investigators" are now rebranded as "adjudicators" and have brought about nearly a 20% increase of informal resolutions, with 63% of all cases in 2015/16 being resolved by way of informal opinions. Yet the path of formal Ombudsman determinations is still available for complainants who are not content with the informal route, or for more niche points of law or policy.

The Annual Report also discusses other changes made by the new Ombudsman, such as the doubling of the minimum award to £500 for those scheme members who have suffered significant distress or inconvenience.

TPO also highlighted some issues that it sees will take prevalence over the coming year, which trustees should be wary of, including:

- An increasing trend in pension liberation cases.
- Complaints surrounding auto enrolment, particularly as 1.8 million small employers are due to comply with the requirements in the coming year.
- The continued "bedding-in" of pensions freedoms.

Considering the performance under Mr Arter's first full 12 months in charge, it looks like TPO is on a strong footing to deal with the complaints that come its way in the next 12 months.

Helpful Links:

- Pensions Ombudsman Annual Report & Accounts 2015/16

BHS AND MARKET VOLATILITY

Tags: Risk Management | Investments | Market Volatility

The BHS Scheme disclosed a surplus in 2008 but had a deficit of £226m by 2015. Similarly the £15bn British Steel Pension Scheme saw its deficit treble over a single year to 31 March 2015, despite holding 70% of the assets in defensive stocks.

Simon Cohen, Chief Investment Officer at Dalriada, commented: "Volatile markets present both opportunities and threats for pension schemes. In order for them to present an opportunity, schemes must monitor their funding level more actively in order to be able to take prompt action to lock-in investment gains and reduce future volatility. Schemes should assess their risks and take control of their strategy to achieve the ultimate goal of paying all benefits to members in full without bankrupting the employer in the process."

"There is fantastic technology available in the market which allows schemes to implement trigger points and monitor their funding level in real time allowing them to switch investments to a more optimal allocation, far more rapidly than ever before – even for small schemes. These trigger points, alongside demanding more of managers, being careful about diversification and perhaps looking at other options like illiquid assets, means scheme trustees can optimise their investments."

Hugh Nolan, a Director at our sister company Spence and Partners, added; "There is always something that schemes can do to address even the most challenging situation. Many schemes (including British Steel) are hoping for a rise in gilt yields to reduce the capital value of benefits promised, but interest rates remain stubbornly low. This gamble may well be appropriate for many schemes, as there is surely more scope for an increase in yields than for a further drop of any real size. Trustees need to consider how much risk they can afford to take, based on their own circumstances, including how strong the sponsoring employer is and what, if any, assets are available to the scheme if things do get even worse.

"Either way, the message is clear. Schemes can take effective action to control risks and minimise costs, as long as trustees and employers are brave enough to avoid the paralysis inspired by the complex problems they're facing.

ACTION

Trustees need to stay in contact with their advisors and continue to monitor the movements of the markets. Get in touch with a contact at Dalriada if you want more advice on putting in place effective monitoring of funding levels.
Employers should ensure that they have a good understanding of and are comfortable with the governance structure in place for this.

PENSIONS AND RETROACTIVE EU LAW – INEQUALITIES PERSIST?

Tags: Pensions Law | Retroactivity

In July 2016 the Advocate General ("AG") provided some hope to members who find themselves worse off by virtue of historically discriminatory laws. Providing her opinion to the European Court of Justice ("ECJ"), in the case of Dr David Parris v Trinity College Dublin, the AG found that there was a case for retroactivity when it comes to laws applicable when a pension accrued.

Dr Parris had been in a same sex relationship for 30 years and entered a civil partnership in 2009 in the UK, on his 63rd birthday, which wasn't recognised in Ireland until 2011. He took retirement in 2010 (in Ireland), but according to his scheme's rules, a member's surviving spouse or civil partner would receive a pension only if the marriage or civil partnership had been entered into before the member's 60th birthday. Given Dr Parris turned 60 before civil partnership was legal in Ireland, it was impossible for his partner to qualify for the survivor's pension.

The AG said that there was no direct sexual discrimination, but that there was indirect sexual (and ageist) discrimination against Dr Parris and his partner, based on the fact it was impossible for homosexual couples to meet the 60 year old age limit set in the scheme's rules.

The AG's opinion seems to be at odds with the conclusions in the recent UK Court of Appeal cases of O'Brien and Walker, by stating that the Equal Treatment Framework Directive should apply retroactively. Contrary to the ECJ's decision of Coloroll, which limited the Barber decision to 17 May 1990, the AG has recommended that the equal treatment rules should be applied, even though the relevant portion of Dr Parris' service pre-dated that legislation..

Helpful Links:

- AG's Opinion on Parris v Trinity College Dublin
- O'Brien & Walker - Court of Appeal Judgment

ACTION

Whether the ECJ follows the AG's opinion will be interesting and well worth keeping an eye out for… hopefully in our next Quarterly Update.

INCOME PAYMENT ORDERS AND PENSIONS OF BANKRUPTS

Tags: Pensions Law | Bankruptcy

Early in this quarter the High Court, in the case of Hinton v Wotherspoon, delivered a judgement that provided clarity on how the pension income of a bankrupt can be subjected to an Income Payments Order ("IPO").

Prior to Hinton, the case of Raithatha v Williamson in 2012 made it clear that an undrawn pension could be subject to an IPO. So, the bankrupt may not have received a penny of their pension in their pocket, but a court could tie the pension to an IPO, or even force the bankrupt to make an election to draw-down. With the subsequent Pension Freedoms removing any restriction on the amount that can be drawn-down, Raithatha made the bankrupt's entire pension open to an IPO.

However, Hinton has disagreed and concluded that only once the bankrupt has elected to draw-down and elected how they are to receive the pension (i.e. lump sum, annuity, payments), can they be said to have an entitlement and then be subjected to an IPO. So, if a bankrupt elects for draw-down but leaves the method and amount of payment undecided, an IPO cannot be attached.

Ho does Hinton affect trustees? Hinton provides much needed clarity on what they (and their administrators) need to do if they receive an IPO in respect of a scheme member. This month the results of the appeal case of Horton vs Henry have been published. The dismissal of this case supports Hinton as it was determined that Mr Henry could not be forced to draw his pension. Though the real impact of Hinton and Horton could come with the interpretation of "entitlement" in the context of the Pension Freedoms and the draw-down process. We are still in the early days of the Pension Freedoms, with many more legal arguments to be made, of which the question of when a member is or isn't entitled to their pension income is bound to be one...

TPR'S REVISED DC CODE & "HOW TO" GUIDES

Tags: Governance | DC | Scheme Management

On 28 July 2016, the TPR published the updated DC code, titled 'Code of Practice No. 13: Governance and administration of occupational trust-based schemes providing money purchase benefits' ("the Code"). The Code details the standards that trustees should meet when providing occupational trust-based DC benefits, including AVCs under occupational DB trust-based schemes.

The Code updates the DC code that was published in 2013. This updated Code reflects the changes to legislation, including the pension flexibilities, charge caps and the governance standards that have been enacted since its predecessor was published.

Along with the Code, the TPR has published 'how to' guides to help trustees meet the standards. These 'how to' guides cover the following:

- The trustee board
- Scheme management skills
- Administration
- Investment governance
- Value for members
- Communications and reporting

Helpful Links:

- TPR Code of Practice

ACTION

Trustees should familiarise themselves with the updated Code of Practice and check whether their scheme meets the standards. Trustees should also check with their legal advisers as to whether any aspect of their scheme needs to meet these requirements.

Employers should be aware of these requirements for trustees, and may wish to review their DC schemes as alternative structures may be available that better fit their needs.

DC CHAIRMAN'S GOVERNANCE REPORT

Tags: Governance | DC | Scheme Reporting

All Schemes with a DC element (other than AVCs) must include a governance statement from the Chair in their Reports and Accounts for periods ending after 5 July 2015.

Do you qualify? The first step is to identify if your scheme qualifies and although in most cases it should be obvious, it is not always the case.

Along with the Code, the TPR has published 'how to' guides to help trustees meet the standards. These 'how to' guides cover the following:

- If your scheme provides only DC benefits then you need a statement (subject to an extremely small number of exceptions).
- If your scheme provides only DB benefits then you do not need a statement.
- If your scheme provides only DB benefits but has a DC AVC vehicle you do not need a statement.
- If your scheme provides both DB and DC benefits then you need a statement e.g.:
  - DB & DC Sections;
  - Not sectionalised but have DB & DC members;
  - Members with DB & DC benefits (e.g. DC top ups);
  - Members with transfers in on a DC basis.
- If your scheme provides benefits that are both DB & DC then it's a little more complicated. If, at any point in the accounting period, benefits were provided on a DC basis or in the most recent valuation the Actuary valued any members on a DC basis, you need a statement.

Helpful Links:

- Section 6 of the Regulator's guide to the DC Code
- Dalriada Blog – Trustees are Responsible

ACTION

The Regulator has already proven that it will punish non-compliers with compulsory fines between £500 and £2,000. Trustees must be aware of the need to produce such statements, what should be included and most importantly that it is their legal responsibility to comply.

Employers should consider whether a DC scheme review is appropriate.

TPR'S AUTO ENROLMENT UPDATE FOR 2015/16

Tags: Auto Enrolment

Headline figures
64,283 employers declared compliance over the period, which represents 58% of total compliance to date. The micro employers have responded and 95% have now complied. The average employer contribution is 3%, well above the 1% minimum. The Regulator has also reported that 66% of the UK workforce is now enrolled in workplace saving vehicles.

Provider Selection
The split of schemes is shown as 8% Defined Benefit/Hybrid and 92% Defined Contribution ("DC"). The DC section is split 59% Master Trust and 34% contract based. Therefore, the prophesied death of contract DC has not yet materialised. The Trust-based DC market is split 98% Master Trust and 2% Trust-Based. This was to be expected, with the success of NEST and the People's Pension, amongst others. Of the 3 million members enrolled over the review period, 97% have entered a Master Trust covered under the assurance framework.

Enforcement
In the 2015/2016 period the Regulator has used its powers 8,812 times. The vast majority being compliance and fixed penalty notices. The Regulator has also issued 400 unpaid penalty notices, and 122 escalating penalty notices. There have been 34 statutory demands for information and 13 statutory inspection notices. There are 7,456 closed intervention cases to date, so action by the Regulator has stepped up considerably over the period.

Forthcoming trends and challenges
The Regulator has identified Master Trust quality, new audiences, contribution phasing and market capacity as key challenges going forward. It is clear that the proliferation of Master Trusts has brought some quality concerns, and the number of employers is a key challenge to the industry capacity. The contribution phasing will mean thousands of step up checks and will be a first test for the already stretched providers.

Helpful Links:

- Automatic Enrolment Report from the Regulator 2015/16

ACTION

Employers should be mindful of their Staging Date. Those who have staged should monitor their re-enrolment requirements. Those who are not comfortable with the quality of their auto enrolment vehicle should consider a DC health check.

21ST CENTURY TRUSTEES

Tags: Trusteeship

The Pensions Regulator launched its '21st Century Trustee' initiative earlier this year. So, what should a modern trustee look like and is more regulation required?

The role of trustee is becoming more and more demanding, requiring individuals to have a high degree of knowledge and understanding of the whole pensions landscape, including scheme funding, investment decisions and employer covenant, whilst keeping in mind above all else, the best interests of their scheme membership.

Regulation of professional trustees should be a good thing with a new benchmark of transparency and governance. However a balance needs to be struck to ensure that qualifications and additional regulation do not scare away the already scarce supply of lay trustees.

Lay trustees – either employer or member nominated – can offer insight that is invaluable on a trustee board. They can add business and covenant understanding, practical scheme knowledge, provide a voice for the scheme membership and be invaluable when it comes to member relations and communication.

In a time of poor funding levels, ever evolving liberation scams and the increased publicity surrounding the likes of BHS and British Steel, people are concerned and looking for comfort that someone trustworthy is looking after their pension. Research recently published revealed that 51% of schemes that had non-professional trustees believed that not all trustees met the standards in the Regulator's 'Trustee Knowledge and Understanding Code'. 5% of schemes admitted that none of their trustees met these standards. There is therefore a certain reassurance around the professional trustee, if you can be confident that they have the necessary knowledge and experience.

There is a strong case for the regulation of professional trustees, although what that should look like is still under debate. Statistics regarding the compliance of lay trustees with the current knowledge and understanding regime are concerning. Although some level of compulsion may be inevitable to ensure that beneficiaries are properly protected, care must be taken not to create a barrier to the invaluable lay trustees.

Helpful Links:

- tPR discussion paper
- Dalriada Blog - Trustees are Responsible

LEVY FRAMEWORK FOR THE THIRD TRIENNIUM

Tags: PPF Levy

The PPF has reviewed the levy framework that will apply for the 2018/19 period (i.e. autumn 2018 invoices). A formal consultation is expected late this year or early next.

The PPF has experienced a significant drop in appeals against invoices, indicating that the model is highly predictive. However, some priority areas remain to be reviewed, in terms of measuring insolvency risk, which are:

Credit Ratings and Industry Scorecards – particularly for regulated financial services entities, large companies with credit ratings, small companies which file only abbreviated accounts and Charity/Not-For-Profit organisations.

Accounting Standard Changes (FRS102) – the PPF is working with Experian on options to manage the impact of pension scheme deficits on company accounts in terms of how insolvency risk is measured.

The following areas will also be reviewed:

- The treatment of investment risk;
- Guidance and requirements in relation to certifying deficit reductions;
- Operation of regimes for certifying contingent assets and asset back securities, and;
- Simplifying the requirements for smaller schemes.

The PPF expects that a review will lead to companies (or trustees) paying a fairer levy, which is more representative of their insolvency risk. However, as with most changes in our industry, there will be winners and losers.

Helpful Links:

- PPF's Third Levy Triennium Update - July 2016

ACTION

Trustees and Companies should monitor information available on Experian's PPF portal in relation to their scheme, understand the options open to improve their levy score and be

familiar with deadlines associated with those options.

INSURANCE ACT 2015

Tags: Buy in Contracts | Trustee Indemnity Insurance

A reform of UK insurance law which impacts all business entities that take out insurance contracts came into force on 12th August 2016. This could impact on pension scheme trustees when obtaining contracts of insurance for their members (such as buy-in contracts) or for themselves, in the form of trustee indemnity insurance.

The Insurance Act 2015 attempts to address the imbalance between the insured and insurer under the contract. It aims to make insurance fairer for policyholders but does also create "additional burdens" on policyholders, as they are now required to provide full information of matters that could be materially pertinent to the insurer when issuing the policy.

Yet, the Act does afford policyholders fair remedies for breaches, meaning that the insurer has less scope to avoid payment due to a minor breach of the policy, and states that any claims must be settled in a reasonable time frame..

Helpful Links:

- The Insurance Act 2015

ACTION

Policies entered into before 12 August 2016 are unaffected, but pension scheme trustees should consider whether any new applications for insurance include all pertinent and accurate information, and whether they know of any additional matters which ought to be disclosed.

EU – US PRIVACY SHIELD

Tags: Data Protection | Data Transfer

On 6 October 2015 the Courts of Justice of the European Union ruled (in the case of Schrems v Data Protection Commissioner) that the Safe Harbour framework (governing transfers of European citizens' data to the US) was inadequate in meeting the EU Directives and was immediately invalidated.

There were fears that the impact on transatlantic commerce would be catastrophic. Therefore, in February 2016, the EU in conjunction with the US drafted and provisionally agreed a replacement, which was finalised by the European Commission on 12 July 2016 – the Privacy Shield framework.

The Privacy Shield requires the US to place more robust obligations on US companies regarding data storage and monitoring, to help guarantee the privacy of all European citizens' data. For the first time, the US also agreed that complete transparency would be implemented in the handling of all EU data by their public and Government agencies. However, it is worth noting that the Privacy Shield only applies to the transfer of data between the EU and the US and does not include any subsidiary businesses in non-US countries.

All businesses that were dependent on Safe Harbour need to ensure that they no longer rely on it for the compliant transfer of data between the EU and the US and give immediate consideration to the General Data Protection Regulation (see next article) and how it impacts their activities.

Helpful Links:

- www.privacyshield.gov
- European Commission Announcement

ACTION

Trustees should review whether they transfer any scheme data to the US.

If applicable, evidencing the move away from using Safe Harbour could be done via a Binding Corporate Rule (which would facilitate inter company agreements) or model clauses.

EU – US PRIVACY SHIELD

Tags: Data Protection | Governance

On 25 May 2018, the existing Data Protection Directive (implemented in the UK as the Data Protection Act 1998 ("DPA")) will be replaced by the new EU General Data Protection Regulation (GDPR). This change is as a result of our ever evolving working environment and has resulted in more businesses resorting to cloud providers to ensure the security of their data, prevent cyber security threats and enhance flexible working. It will also harmonise data protection with a single legal framework, applying across all EU member states.

The majority of the GDPR's core principles are much the same as those in the current Data Protection Directive. Therefore, if you are complying with the existing regulations the implementation of this new Directive will be not be as painful as one may think. However, the GDPR has placed considerably more emphasis on governance and accountability, with a number of points to highlight:

1. Both the Data Controller and the Data Processor will be equally liable for monetary penalties and fines.

2. A Data Protection Officer must be appointed to take responsibility for data protection compliance and governance.

3. The maximum fine for data protection breaches increases from £500,000 to 5% of global turnover or €100 million.

4. A 72 hour notification period to the Information Commissioners Office ("ICO") from knowledge of a data breach, with notice to affected data subjects "without undue delay".

5. All data protection breaches, regardless of whether they are prosecuted or not shall be recorded on the ICO website and accessible to the public.

6. Individuals will have a right to claim compensation for damages due to a breach, whether caused by the Data Controller and/or the Data Processor. This includes the right to non pecuniary damages for distress.

7. Explicit consent required for data collection, usage and marketing – implied consent will no longer be allowed.

8. The "right to be forgotten" – individuals must be provided with the option to have their data deleted.

Post Brexit
The GDPR will come into force on 25 May 2018. If the UK is still a member of the EU at that time, organisations conducting business in the UK will have to comply with the Regulation. When the UK does trigger exit from the EU, Parliament will have to consider enacting legislation that either retains the GDPR in full or replicates its requirements.

The UK Parliament is unlikely to pass legislation that would significantly diverge from European requirements – negotiations around maintaining trade links would be hampered if the UK wasn't an "adequate" country to accept data transfers from EU States. Therefore, schemes and sponsors alike will need to ensure their processes are in place to meet GDPR standards.

Helpful Links:
- Information Commissioner's Office Summary of GDPR

Deadline: 25 May 2018

ACTION

Strategic Risk Registers will need to be revisited to reflect the increased fines for breaches and the right of individuals to claim for compensation.

A Data Protection Officer should be appointed.

Processes should be in place to meet the new explicit consent, "right to be forgotten" and notification period requirements.

WHAT'S COMING UP?

Looking ahead to the next quarter, there are sure to be more developments in regard to the fallout from Brexit, but it's also worth trustees and sponsors looking out for the following:

- Phillip Hammond has announced that his first Autumn Statement will be delivered on 23 November 2016. The usual rumours in regard to pensions reforms are circulating, so there may be plenty to update on in the next Quarterly Update (or may be not!).
- The Work and Pensions Select Committee will meet in October to discuss whether struggling DB schemes should be permitted to break their pensions promises and change the annual inflation-linked increases they have contracted to pay pensioners. This is a continuation of the debate surrounding struggling schemes and the conclusions of their meeting will be well worth examining.
- The Department for Work and Pensions issued a consultation in September seeking views on how the advice requirement operates for overseas transfers and how it could be made to work better in such cases. The deadline for responses to the consultation is 23 December 2016.
- The Government published a consultation on the future of Salary Sacrifice, which is due to close on 19 October 2016. The government will make an announcement at this year's Autumn Statement on decisions made in light of the responses received. From the terms of reference, it looks unlikely that this will impact on pension contributions, but any policy changes are expected to feature as part of the Finance Bill 2017.
- The responses from the Government on a secondary annuity market are expected. It is anticipated that a further consultation on advice and guidance requirements will quickly follow.

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