

Pennines RBS

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Annual Governance Statement by the Chair of the Trustee for the Scheme Year Ending on 31 March 2017

Introduction

New governance rules apply to defined contribution ('DC') schemes, and therefore the Scheme, from 6 April 2015.

As the Chair of the Trustee, I have to provide you with a yearly statement which explains what steps have been taken by the trustee to meet the new governance standards. This statement covers the Scheme year from 1 April 2016 to 31 March 2017.

What has to be included in the statement is set out in law. Under normal circumstances the statement will relate to a DC scheme properly established to provide appropriate benefits for its members.

As you are aware from the Announcements issued to members since its appointment, Dalriada Trustees Limited ("Dalriada") was appointed as trustee to the Scheme by the Pensions Regulator amid concerns that the Scheme was being used as a vehicle for pension liberation. This has presented Dalriada with a number of challenges around governance. Nevertheless this statement is a legal requirement and, as such, can serve as a useful reminder of the issues faced by Dalriada and, where it cannot meet certain governance obligations, I have explained why that it is the case.

Background

Dalriada was appointed as Independent Trustee of the Scheme by Order of the Pensions Regulator on 28 March 2012. The powers and duties exercisable by Dalriada in its capacity as trustee are to the exclusion of all other trustees of the Scheme.

The Scheme was used, principally, as a vehicle to allow members under the minimum retirement age of 55 access to their pension funds by way of a loan.

The Scheme had a single investment being the investment in preference shares issued by Hedge Capital Investment Group plc (HCIG). Loans to members were made by another Group company, Hedge Capital Limited, which, in turn, was funded by way of a loan from a further Group company, Hedge Capital Investments Limited (HCIL), a company wholly owned by HCIG.

These loans were seen as unauthorised payments by HMRC who, as a result, have issued provisional assessments for significant tax charges against both the Scheme and its members.

As well providing the funds to loan back to members, HCIL invested further funds in a number of unusual and high risk investments.

Default investment arrangement

The Scheme did not offer members any choice as to how their funds were invested, funds being used to secure preference shares in HCIG.

Alongside the loans to members, funds were invested by HCIL (a subsidiary of HCIG) in a number of unusual, high risk and largely illiquid investments which are difficult to value.

As such, in Dalriada's view, there has never been an appropriate default investment arrangement. There is no life-styling option available.

The previous trustees directed investment decisions without seeking appropriate investment advice.

No serviceable Statement of Investment Principles exists for the Scheme.

As the investments are unconventional and they do not comply with any maximum charge requirements.

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Dalriada is not in a position to rectify any of these deficiencies at the current time.

As members will be aware, Dalriada was looking to reach a settlement with Hedge that will allow it to take ownership of the Hedge companies and, thereafter, attempt to recover funds where it can. Once it has identified what assets are recoverable, Dalriada will take appropriate advice to determine a suitable investment strategy.

Dalriada will also then put in place a suitable Statement of Investment Principles.

As reported in the Scheme's Report and Accounts, the settlement with Hedge has now been concluded and Court sanction obtained. Dalriada is now in position to move matters forward with regard to the Scheme's investments and, in time, details of the revised investment strategy and confirmation of any investment choices being made available will be set out to members. Ultimately, it is Dalriada's intention to wind up the Scheme as soon as it is able, giving members the opportunity to transfer any funds to a more suitable arrangement of their choice.

Core Financial Transactions

Trustees have a specific duty to ensure that core financial transactions relating to DC schemes are processed promptly and accurately. These include the following:

- investing contributions in the Scheme
- transferring assets related to members into or out of the Scheme
- transferring the assets between different investments within the Scheme
- making payments from the Scheme to or on behalf of the members.

The Scheme does not currently accept contributions or transfers in and is unable to pay any level of benefit, including transfers values, to members at the present time.

This is due to a number of factors, not least uncertainty, to date, as to the value of the Scheme's investments and the position with regard to the potential tax charges mentioned above. More information on this has been provided in Dalriada's Announcements to members.

The Financial Transactions the Scheme does make are, in the main, in relation to costs. These are reported in the Scheme's annual accounts.

Given its inability to carry out routine administrative actions, unsurprisingly, over the reporting period, there have been no material administration service issues which need to be reported here by Dalriada.

Notwithstanding this, Dalriada, as a professional Independent Trustee, has processes and controls in place that are suitably designed to ensure any service objectives can be achieved once the Scheme is in a position to operate in the manner of a normal scheme.

Charges and Transaction Costs

The new governance rules require trustees to make an assessment of the charges and transactions costs borne by DC scheme members.

Since its appointment, there have been no transactions as Dalriada has not accepted any payments into the Scheme, either by way of contribution or transfers in.

Under the terms of its appointment, the fees of Dalriada and its advisers are met from Scheme funds. Whilst these costs fall as debt due from the employer (or sponsor), in this case the sponsor was a dormant company with no assets.

Due to the mismanagement of the Scheme by its previous trustees and the subsequent actions taken by Dalriada since appointment, it is inevitable that the Scheme has incurred, and will continue to incur, significantly higher ongoing costs than would be the case for a similarly sized but conventional scheme.

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Dalriada has set out in its various Announcements to members the actions it has taken to take control of the assets that underpin the investments made by the previous trustees. Generally, actions undertaken by Dalriada, beyond those considered necessary for the appropriate management of the Scheme, are centred on legal action around recovery of funds. Such actions are considered on a cost benefit analysis and, where necessary, Court approval is sought for the use of Scheme funds to pay for such legal action.

Good value for members

When assessing the charges and any transaction costs which are payable by members, trustees are required to consider the extent to which the investment options and the benefits offered by the Scheme represent good value for members when compared to other options available in the market. Given the particular circumstances of the Scheme, such a comparison is simply not possible.

Generally, Dalriada's aim is to recover what assets it can, as cost effectively as it can, to resolve the position with HMRC as regards the possible taxation of Scheme assets and, thereafter, to determine the value of members' funds and provide members with appropriate options prior to, ultimately, winding up the Scheme.

Trustee Knowledge and Understanding

The law sets out the requirement for trustees to have appropriate knowledge and understanding of legal requirements relating to pensions and trusts, the funding of occupational pension schemes, investment of Scheme assets and other matters to enable them to exercise their functions as trustees properly. This requirement is underpinned by guidance in the Pension Regulator's Code of Practice 7.

Dalriada, as a professional trustee, meets all knowledge and understanding requirements. A record of the training completed by Dalriada staff is kept and this training record is reviewed periodically to improve standards. Dalriada also seeks external specialist advisers when required.

All current Dalriada staff have completed the Trustee Toolkit made available by the Pensions Regulator. New staff must complete the Toolkit after joining Dalriada.

As a result of the training activities which have been completed by Dalriada staff individually and collectively, and taking into account the professional external advice available to Dalriada when required, Dalriada considers that its combined knowledge and understanding enables it to exercise properly its function as trustee of the Scheme.

Signed for and on behalf of Dalriada Trustees Limited (the trustee)

Chairman.....