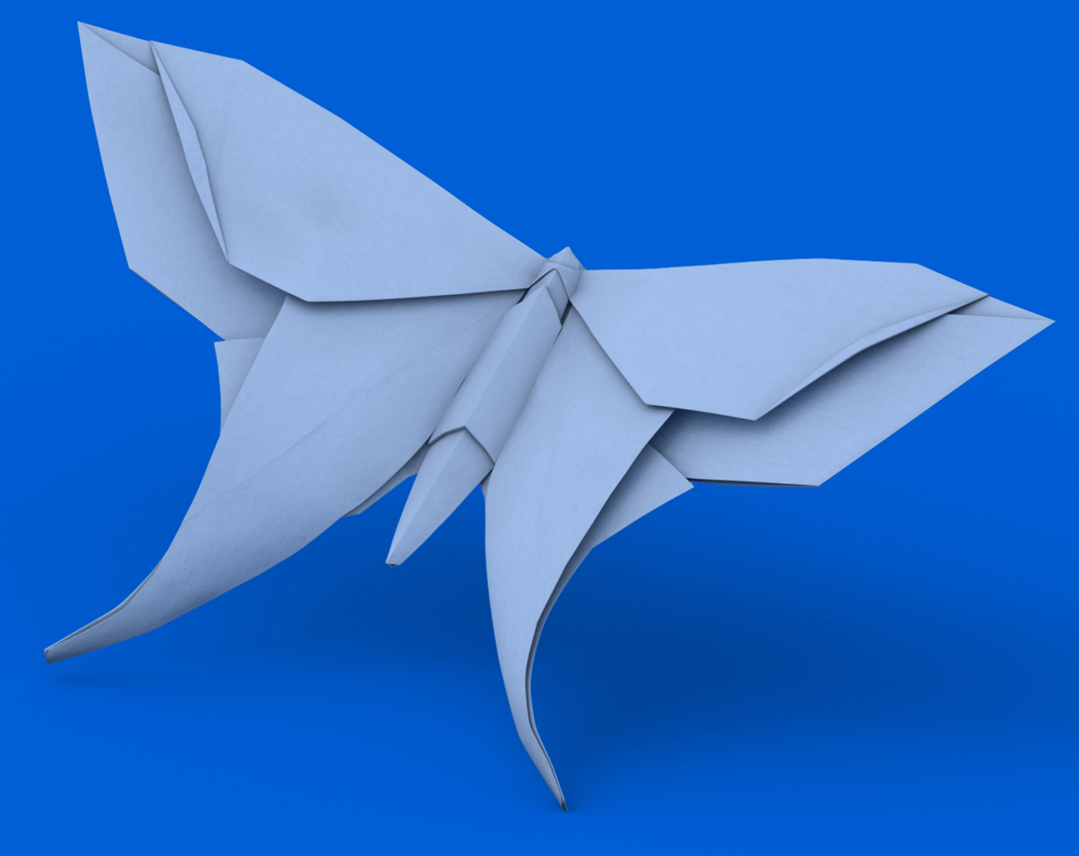
Your Quarterly Pensions Update

Dalriada Trustees – Industry Changes

Quarter 4 2020



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1 Introduction

The purpose of this report is to provide an update for pension scheme sponsors and trustees on recent industry changes in the quarter.

For your convenience, we have summarised the key developments and highlighted the necessary actions sponsors and trustees may need to take.

We also include links to 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 Adrian Kennett, adrian_kennett@dalriadatrustees.co.uk or your usual Dalriada contact.

NOTES

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 Trustees Limited accepts no liability for actions taken or not taken as a result of this document.

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2 Review of 2020

What happened in 2020 and what to look out for in 2021

Understandably, many of us will want to put 2020 in the rear-view mirror and start looking forward to a, hopefully, better year in 2021.

That said, developments in pensions law and practice did not stop during the 2020 lockdowns and there were in fact some important changes even before many of us had even heard of 'furlough'.

We consider some of the key developments for pension scheme trustees immediately below and this is followed by a bit of crystal ball gazing to tease out the issues that trustees should have on their radars for 2021.

Q1, 2020

As will be seen, 2020 was a year of pension 'themes' in terms of new law and practice.

The year started with the re-introduction of the Pension Schemes Bill into Parliament, following the dissolution of Parliament at the end of 2019. The Bill has progressed throughout the year (as elaborated on below) and we will finish our commentary looking at what 2021 has in store for it.

Q1, 2020 was also a milestone for the Pension Protection Fund (PPF) as The Carillion Rail (GTRM) Pension Scheme became the 1000th scheme to transfer to the PPF since its inception. It is too early to say how many schemes will follow it this year, especially when the economic impact of the global pandemic is not properly understood, but the importance of the UK pensions lifeboat has never been greater.

Other notable developments from the first three months of the year include:

- The Courts grappling with more RPI/CPI cases, where trustees and employers sought clarification on the correct measure of price inflation for increases to pensions in payment. A consultation on reform of RPI was published.
- TPR's response to its consultation on the 'future of trusteeship and governance', which received a record 114 written responses. TPR also published the first stage of a major consultation on its revised Code of Practice for defined benefit pension scheme funding.
- HMRC publishing the first of two newsletters of the pension tax implications of addressing inequalities arising from Guaranteed Minimum Pensions (GMPs).

And there was, of course, a constitutional milestone in the form of The EU (Withdrawal Agreement) Bill receiving Royal Assent and allowing the UK to leave the EU on Friday, 31 January, at 11pm (with a transition period until 31 December 2020).

So, the beginning of 2020 was a busy time for UK pensions and there was no let up as the pandemic started to take hold.

Q2, 2020

In Q2,2020, we saw more failed attempts by pension scheme sponsors to reduce their pension liabilities by changing the measure of price inflation for increases to pensions in payment from RPI to CPI.

We also had to digest TPR's annual funding statement which, not surprisingly, focussed on guidance for completion of valuations in the Covid-19 environment. This statement from TPR was supplemented with specific guidance designed to help pension scheme trustees and employers cope with the financial impacts of Covid-19.

In another response to the pandemic, the Corporate Governance and Insolvency Bill was published to provide greater opportunities for corporate survival and better returns for creditors during and after the Covid-19 emergency. This Bill quickly received Royal Assent and the Act has important implications for pension schemes as material, but usually unsecured, creditors of their sponsoring companies.

Long-awaited interim superfund guidance appeared, setting out TPR's expectations for DB consolidator schemes.

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Last but not least, we got the High Court ruling in the Hughes case where it was held that the PPF compensation cap age is discriminatory (this ruling now being appealed).

Believe it or not, this only takes us to the start of the second half of 2020!

Q3, 2020

The third quarter of 2020 was comparatively quiet relative to Q1 and 2, but still notable for at least the following developments:

- Another 'Barber equalisation window' case (Safeway v Newton), 30 years on from the Barber v GRE case which held that pensions are pay and must be equal as between comparable men and women.
- More on GMP equalisation in the form of a second HMRC Newsletter, covering lump sum payments, and PASA guidance, covering data and member communication.
- A pensions tax relief consultation, which many consider to be a precursor to more far-reaching reform that could entail the end of marginal rate relief on pension contributions.
- A consultation on climate change – a topic that is set to become one of the issues of the decade for trustees.
- Another consultation, this time on defined contribution (DC) outcomes and likely to lead to further consolidation of DC pension schemes.
- Legislation providing that debts owed to HMRC following company insolvency are to have secondary preferential status from December 2020, potentially further undermining recoveries to pension schemes with sponsors unable to pay their debts.

This brings us, finally, to the last quarter of an unprecedented year.

Q4, 2020

TPR is asking us to "pledge" to combat pension scams by signing up to their latest campaign for protecting pension savers. On a related note, the High Court clarified how the legislation governing the Fraud Compensation Fund (FCF) should be interpreted, paving the way for pension scam victims to claim compensation.

The High Court also told us, in the second Lloyds Bank Pension Schemes case, that trustees of DB schemes, which provide GMPs, are required to revisit and, where necessary, top-up historic cash equivalent transfer values that have been calculated on an unequalised basis.

And the Government confirmed that the Retail Prices Index will be reformed to align with the Consumer Prices Index, including owner occupiers' housing costs, but not before February 2030 (and with no compensation for holders of index-linked Gilts).

What to expect in 2021

Recent news on various vaccines (at the time of writing, the UK has just approved a third one) provides hope that life will start to return to 'normal' (although, the new normal is likely to feel quite different in areas such as the workplace).

For pension schemes, which have successfully continued to serve their members throughout 2020, the next twelve months look like business as usual with no let up in developments for trustees to grapple with.

Noting that there will be many others, here are just some issues for trustees to have on their risk registers and business plans –

- Brexit and, in particular, the end of the transition period which was accompanied with an eleventh-hour deal between the UK and EU.
- The Pension Schemes Bill, mentioned at the start of this article, which contains important provisions around TPR powers, scheme funding, collective DC schemes, the Pensions Dashboard, restrictions on transfer rights and more measures on climate change.
- Economic 'fall-out' from Covid-19.
- GMP equalisation, with schemes finally 'doing it'.
- Legislation for commercial consolidators and superfunds.
- TPR's consultation on a new DB funding framework.
- Outcome of TPR's consultation on 21st century trusteeship.
- Climate change.

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3 GMP Equalisation and Historic Transfers

Overview

GMP Equalisation is a topic that has featured in our quarterly updates for some time and this quarter is no different. During Q4 2020, a further hearing was held in the Lloyds GMP equalisation case in relation to historic transfers out. This was an area which was 'carved out' of the original judgment in 2018.

For the time being, this is the final judgment we are expecting in relation to GMP equalisation although there may be further industry guidance.

The Judge ruled that past statutory transfers, which were not equalised for the unequal effects of GMPs, should be re-visited and equalisation payments made, where required, either to the receiving schemes or potentially direct to members. This does not override the requirement for schemes that have accepted transfers-in, which include post 17 May 1990 GMPs, from equalising these benefits, along with the wider GMP equalisation project.

Detail

- The transferring trustee committed a breach of duty in paying an inadequate transfer value and remains liable to the member.
- In respect of individual transfer payments made under overriding cash equivalent transfer value (CETV) legislation, the transferring trustee owes an obligation to the transferred member in relation to transfers regardless of the type of receiving scheme. To satisfy this obligation, trustees will need to make a top-up payment. The transferring trustees do not have to provide a residual benefit from within the transferring scheme.
- All top-up payments should bear interest at 1% above base rate.
- The transferring trustee's obligations are not relieved by the discharge provisions in the CETV legislation or the Limitation Act 1980.
- The forfeiture provision under the scheme rules does not apply in the case of past transfers-out.
- There is no requirement to top-up 'rules based' (i.e. non-statutory transfer values paid under the scheme rules), as under preservation legislation the member no longer has rights in the scheme. However, members could go to the courts to seek a review where there was a breach of duty. Bulk transfers carried out on a mirror image basis also do not need to be revisited.
- Transferring trustees need to be proactive in respect of those members that took statutory transfers where those transfer values were not equalised. They must consider the following to determine what to do:
  - identify which former members were impacted and calculate any top up;
  - consider how they will settle any top up; i.e. second payment to the receiving scheme or a cash payment directly to the member;
  - as there is no time limit, revisit transfers that took place from 1990 up to the present day where they included post 17 May 1990 GMP.

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The judge was asked not to reflect on the wider consideration of administrative costs. Trustees will need to seek their own advice on what the options are for cases where the costs involved would outweigh any uplifts to members.

ACTION

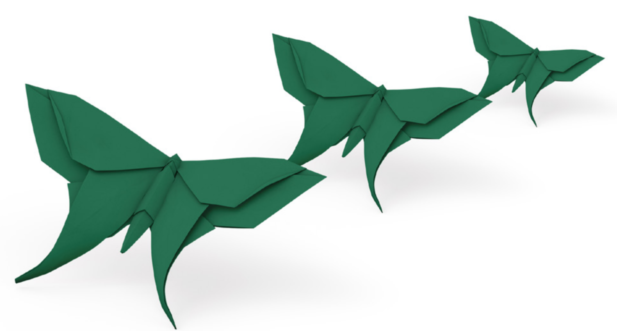
Trustees should begin to collate data to understand the potential number of members impacted and the extent of the potential top-ups that may need to be paid from the scheme.

This should not stop trustees from pressing ahead with equalising GMP benefits for current scheme members.

Separately, employers should consider if the annual accounting figures will need to include an additional adjustment in respect of top-ups that are expected to fall due in relation to past transfers.

Helpful Links

https://www.bailii.org/ew/cases/EWHC/Ch/2020/3135.pdf



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4 Pension Scams - Key Developments

The tail-end of 2020 saw a welcome focus on how the pension industry can better tackle the scourge of pension scammers and find some redress for their victims.

The Pledge

The Pensions Regulator (TPR) launched a major new campaign, supported by the Pension Scams Industry Group (PSIG), calling on the industry to publicly pledge to combat pension scams. Pension providers, trustees and administrators are urged to help protect members thinking of transferring or looking to drawdown from their pensions, by ensuring that they can spot the warning signs of current and emerging scam tactics, adopt best practice when it comes to transfer due diligence and inform members of any risks when they look to make a transfer.

To assist, TPR has launched an online interactive training module as part of its Trustee Toolkit, outlining the stringent processes it expects all trustees and providers to follow to keep savers safe. PSIG will also be issuing an updated version of its Code of Good Practice in early 2021, probably before new regulations (curtailing transfer rights where a pensions scam is suspected) are expected to come into force.

Minister for Pensions and Financial Inclusion, Guy Opperman, said: "I would encourage all pension providers, trustees and administrators to pledge their commitment to this campaign and help do their bit to crack down on pension scams". Trustees, advisers and providers can sign up to the pledge through the TPR website (see Useful Links below). Dalriada supports the principles behind the pledge and will work with TPR and our third-party administrators with regard to compliance. Dalriada is a member of PSIG and its trustee representatives are required to complete all modules of the Trustee Toolkit, including the new module addressing the pension scams.

Meeting the Pledge

Those that make the pledge to combat pension scams are self-certifying that their organisation has put in place practices to meet the six steps, namely:

- Regularly warn members about pension scams.
- Encourage members asking for cash drawdown to get impartial guidance from The Pensions Advisory Service.
- Get to know the warning signs of a scam and best practice for transfers by:
  - completing the scams module in the Trustee Toolkit (see below) and encouraging all relevant staff or trustees to do so;
  - studying and using the resources on the Financial Conduct Authority ("FCA") ScamSmart website, TPR's Avoid pension scams site and the PSIG code;
  - considering membership of the Pension Scams Industry Forum.
- Take appropriate due diligence measures by carrying out checks on pension transfers and documenting pension transfer procedures.
- Clearly warning members if they insist on high-risk transfers being paid.
- Report concerns about a scam to the authorities and communicate this to the scheme member.

These six steps represent the minimum that TPR expects from pension providers, trustees and administrators to protect scheme members. Members of the industry can go further by using the PSIG code, which details more steps you can take to protect members.

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Scams Module in the Trustee Toolkit

To support the pledge, TPR has also introduced a new module to the Trustee Toolkit, completion of which will be necessary for firms to self-certify as above. As described by TPR, the module is designed to help trustees, administrators and providers:

- identify the common warning signs of a pension scam;
- define expectations about communicating regular scams warnings to members, both on an ongoing basis and for events such as a transfer request;
- understand the questions they can ask members to help protect them from scammers; and
- describe what constitutes appropriate and proportionate due diligence on transfers.

Dalriada is making it a requirement on all staff involved in pensions delivery and consultancy to complete the module.

FCF Judgment

Away from the attempts to prevent scams occurring in the first instance, there was a significant ruling from the High Court that may bring restitution for those who have already become victims of the scammers.

Background

The Fraud Compensation Fund ("FCF") was established under the Pensions Act 2004. The Pension Protection Fund ("PPF") is responsible for the operation and management of the FCF, which is otherwise a separate fund from the PPF itself. However, it has rarely been called upon and was not designed with those pension schemes suspected of being a scam in mind.

The FCF is open to claims by occupational pension schemes that have suffered a loss as a result of an act of dishonesty. However, the wording of the legislation in regard to the eligibility for compensation was not clear. Therefore, the PPF sought clarification from the courts on the proper interpretation and application of the rules, (via a 'Part 8' application), in order to determine if claims could be submitted to the FCF for compensation in relation to such schemes. These were entirely non-adversarial proceedings, in which Dalriada participated, with the Secretary of State for Work and Pensions joined as an interested party.

The Judgment and Next Steps

On Friday 6th November, Mr Justice Trower handed down his judgment in the case, determining that a significant number of pension schemes can, in principle, make applications to the FCF.

The ruling has been welcomed as being generally positive for many members who have been the victims of the scammers, but there is still some uncertainty as to which schemes will be eligible for compensation.

While the judgment has provided answers to some fundamental questions posed to the Court, some uncertainty remains over the extent to which schemes used for pension liberation activity or were otherwise suspected of being a scam will be able to access compensation and there is still a lot of work to be done to establish whether such schemes are eligible for compensation from the FCF. This process may take a number of years to conclude, with the PPF and trustees of such schemes working collaboratively.

Crucially, evidence of dishonesty needs to be established and how the PPF determines this will dictate how much compensation might eventually be paid. The FCF is also a fund of "last resort", meaning that trustees of these schemes (generally appointed by TPR) should have exhausted other avenues for recovering the money lost by the members before applying to the FCF.

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Importantly, the FCF relates only to occupational pension schemes. So, FCF will not provide redress for individuals who have transferred to other types of pension scheme (such as personal pension schemes) or who have been the victim of investment scams outside of a pension arrangement (albeit the Financial Services Compensation Scheme might be available to them).

Other Developments

After announcing an inquiry into the impact of pension freedoms and the protection for pension savers, the Work and Pension Committee ("WPC") began their hearings in earnest in September. The first limb of the three-stage inquiry focused on the steps taken in the industry to prevent scams in the first instance. Dalriada provided written submissions to the inquiry and was subsequently asked to make oral submissions. The WPC aims to shine a light on the true scale of the pension scam problem, the methods used by the scammers and the role that trustees, administrators and pension providers can play in stymying the criminals.

In a welcome move, to give the industry more power to put a halt to suspect transfers, the government intends to implement new regulations as part of the Pension Schemes Bill. Specifically, the regulations will remove the statutory right to transfer when certain "red flags" exist and will apply to both DB and DC schemes. While the details have yet to be clarified by the government, PSIG and the WPC have identified typical "red flags" as being:

- the receiving scheme (or other parties in the transfer) do not have the required Financial Conduct Authority (FCA) permissions;
- Uncertainty as to how funds are to be invested or what charges are to be applied;
- the member was contacted via social media, email or cold calling, or was offered free pension reviews or early access to cash;
- the member has been pressured to transfer quickly;
- the receiving scheme is not registered with HMRC.

It remains to be seen how these regulations will ultimately be drafted, but it will be imperative that the red flags chosen are clear enough to allow trustees to refuse suspect transfer requests. Empowering trustees with the ability to halt transfers will be an important step in the right direction to reducing the incidence of pension scams, so we eagerly await further news of draft regulations.

Helpful Links

Join the PSIG

Trustee Toolkit - Scams module

TPR Guidance on Pension Transfer Due Diligence

PSIG code

TPR - Scams Information

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5 2020 Q4 Investment Update

The CMA Order

New requirements from the Competition and Markets Authority ("CMA") came into force during the last quarter, under the Investment Consultancy and Fiduciary Management Market Investigation Order 2019 ("the Order").

By 7 January 2021, trustees needed to submit a compliance statement to the CMA, stating that they have complied with the requirements of the Order that applied to their scheme. Depending on the circumstances of the scheme, the requirements under the Order include:

- trustees to set strategic objectives for their investment consultants
- mandatory tendering for fiduciary management services (see below)
- providing disaggregated fees in respect of Fiduciary Management Services.

Going forward, compliance statements must be submitted by trustees on an annual basis. This should therefore be recorded in scheme business calendars and appropriate governance processes put in place to monitor compliance with objectives and tendering requirements (as appropriate) on an ongoing basis.

Where trustees have existing fiduciary management agreements, which collectively account for 20% or more of scheme assets, and they:

- entered into one or more of those agreements before 10 June 2019, and
- some or all of those agreements did not result from a competitive tender process

Then for all fiduciary management appointments that were not competitively tendered, trustees must:

- carry out a competitive tender process, and
- complete the competitive tender process for all these appointments within five years from the date of commencement of the first fiduciary management agreement, which was not competitively tendered.

Where the five-year period expires before, on, or within two years of 10 June 2019, trustees must complete a competitive re-tender no later than 9 June 2021.

Schemes with a FM in place should consider the circumstances that apply to their appointment and put in place processes to monitor compliance with the re-tendering requirements. Trustees should consider the length of time it will take to run the tender exercise and plan ahead.

Investment Market

The final quarter of 2020 saw a continued improvement in capital markets as they climbed from March 2020 lows, with global stock markets up by around 9% and credit spreads declining. Governments continued to provide support to tackle the economic impact of the Covid-19 pandemic, announcing new packages of spending to aid the recovery. Positive news regarding the approval of various vaccines also boosted investor optimism, with sectors such as financials, energy, retail, hotels and airlines posting strong gains as a result. While the vaccine progress was not positive for all, with the sectors that had seen growth in the earlier part of the pandemic, such as tech stocks, underperforming.

Long-term nominal and real UK gilt yields marginally decreased (i.e. prices increased) over the quarter. All else being equal, this acts to increase the value placed on the liabilities of pension schemes.

Corporate bonds performed well and outperformed government debt over the period. Investor sentiment increased as riskier high yield bonds outperformed investment grade rated bonds. Globally government bond returns were mixed, with US bonds posting losses as yields increased due to the new support packages increasing supply, while German, Italian and Spanish bond yields fell.

Oil prices rallied around 25% over the quarter as news of a vaccine lifted hopes for a global economic recovery in 2021 that is expected to lead to increased demand for oil. The price of gold was flat over the quarter, while Bitcoin was up approximately 270% as more investors were attracted to the alternative asset.

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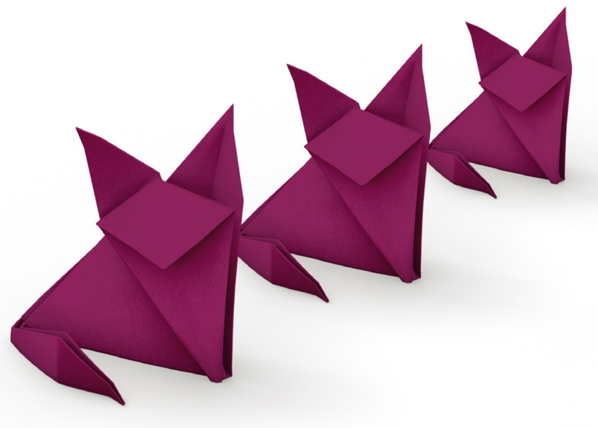
UK equities performed well over the quarter, up around 13%. The Covid-19 vaccine and an agreement on a Brexit trade deal were the main drivers, with domestically focused companies outperforming. This was despite a surge in new Covid-19 cases and stricter lockdown restrictions being imposed across the nation. Sterling also increased 5% over the quarter versus the US Dollar.

US equities rose about 7% over the quarter as the vaccine and a $900 billion stimulus package were rolled out. The former was announced late in December, which buoyed investor sentiment and caused stocks to post their best quarter since 2009. Joe Biden's win in the US presidential election earlier in the quarter was particularly positive for small cap stocks, which have significantly outperformed mega cap stocks since the election, as they benefit from the prospect for more fiscal spending under a Democratic government.

Emerging market equities were up 13% and had their strongest quarterly return in over a decade, with the decline in the US Dollar supporting those gains. China also posted strong returns, as its economy almost returned to pre-pandemic levels of output and Chinese exports increased to the highest monthly nominal level on record.



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6 Distressed employer guidance from TPR

Overview

Recent guidance from The Pensions Regulator (TPR) urges trustees of defined benefit (DB) pension schemes to prepare now in case their sponsoring employer faces financial difficulties. It encourages trustees to monitor the covenant and adopt an integrated risk management (IRM) approach, even if the employer is not currently in trouble. As we hopefully emerge from the Covid-19 pandemic and government support begins to be withdrawn and associated deferred debts fall due, this is all the more important.

Key points from the guidance include

- All trustees should adopt a fully documented IRM approach to their scheme, with workable contingency plans and suitable triggers in place.
- Practising IRM will highlight problems early on, and the sooner trustees act, the greater the prospects of protecting the scheme's position. Trustees should regularly review these risk management and governance procedures to make sure they are fit for purpose.
- Engaging regularly with the sponsor and with other creditors (where applicable) to identify and manage key risks early on.
- If trustees delay putting robust scheme protections in place, other stakeholders, such as lenders, will be in a better position to exert control over and extract value from a distressed sponsor, potentially to the detriment of the scheme.
- Trustees should remain alert to pensions scams or unusual transfer activity and prepare a communications strategy to support members when they are facing uncertainty.
- If a sponsor is facing the prospect of insolvency, trustees should refer to the Pension Protection Fund's contingency planning guidance.

The guide is aimed at trustees and, very usefully, includes practical recommendations, case examples and a checklist to use during periods of sponsor distress.

The concept of a corporate stress curve is used to illustrate a hypothetical employer's downturn towards insolvency. It picks out strategies that trustees should focus on, depending on where their employer sits along the curve and highlights the steady decrease in options for trustees as a sponsor becomes more distressed.

So far so good.

Our experience entirely supports the contention that the earlier monitoring regimes are set up and key information about a sponsor's performance and the positions being taken by key financial stakeholders is obtained the better equipped trustees are to respond to an employer's overtures for support or to defend a scheme's position from the unintended consequences of any new or additional requirements being sought from other financial stakeholders.

The guidance identifies that at times of distress; actions taken by employers, often under pressure from other financial stakeholders, can adversely affect the schemes position as a creditor or even cause scheme losses.

Again, we at Dalriada would agree with this. Quite often the price for continued banking support, possibly at lower levels than previously provided, is incremental pricing and security that has an adverse impact on the scheme's position. All too often these requests, or a trustees' knowledge of them, comes at the last minute where at first flush there might appear to be few options but to accept the proposition and take the medicine.

It is our experience that quite often such adverse consequences for the scheme are not intentional. Proposals can be structured or reworked such that, in return for lending its support as a major creditor, the scheme can take part - having its position protected (or at least have the adverse impact minimised) - with options for being rewarded in the event of a later successful restructuring or a return to profitability.

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The guidance is very timely given the impact of Covid-19 (which is mentioned in the guidance) and the prospect of a material increase in distressed sponsors and insolvencies when government support schemes (such as furlough) end at some point this year. A key message is that trustees should act now to ensure they are prepared for the risk of employer distress and have more protections or triggers in place to protect their schemes from any negative impact in the event the worst-case scenario materialises.

It is our view that it is in employer's and scheme's best interests for trustees to understand when underperformance is turning into stress, stress to distress and distress to the risk of insolvency.

Ideally, as a minimum, trustees should seek to ensure they are provided with early information that explains the declining performance of their sponsor preferably before it turns into stress. It is also essential to understand the position of the sponsor's other financial stakeholders and their capacity to alter the terms upon which they provide support to a sponsor. Matters to consider include lender covenant compliance, facility repayment and renewal dates and the implications of their interaction with audit sign off. Credit insurance arrangements or major contract renewal dates, production levels and order book sizes and lead times are also worth knowing about.

Quite often, and as a starting point, the key metrics used by management to understand the performance of the sponsor and which are regularly reported upon at Board meetings can form a major part of the information provided to the trustees.

Finally, whilst it is ideal for triggers and consequent actions for breach to be agreed with employers, we recognise that in practise this is often easier said than done. If this is not possible then it should not stop a trustee from having their own triggers to promote a conversation or pro-active engagement with an employer or indeed consider whether they need to revisit the appropriateness or otherwise of say: valuation assumptions, investment strategy or transfer policies or to commence active contingency and additional communication planning.

Protecting schemes from sponsoring employer distress | The Pensions Regulator

PPF Contingency Planning Document

Trustee Checklist to reduce scheme risk of sponsor distress

Corporate Stress Curve

Clearance | The Pensions Regulator

How to notify us under this framework (thepensionsregulator.gov.uk)

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7 The Pensions Regulator 15 year strategy

Overview

The Pensions Regulator (TPR) has launched a discussion on its 15-year corporate strategy to protect savers.

Reflecting the changing nature of workplace pensions, the Corporate Strategy, which should have been issued in the Spring but was delayed because of the Coronavirus, outlines a shift in focus, over time, from defined benefit (DB) to defined contribution (DC) pensions, at least in the private sector. The strategy also builds on TPR's transformation to be a 'clear, quick and tough regulator'.

The strategy analyses different groups of savers by generation – Baby Boomers (born between 1946 and 1964), Generation X (1965 and 1984) and Millennials (1985 and 2004) – recognising that each group faces different life circumstances and risks in relation to their pensions (see the extract below, noting that, strangely, TPR assumes that any reliance on State pension applies to low-income savers, only).

For younger savers automatically enrolled into DC pensions, it is observed that 'investment performance',

'value for money' and 'at-retirement decision-making' will play a much greater role in retirement outcomes. From this analysis five strategic priorities emerge:

- **Security** - protecting the money that savers invest in pensions. Maintaining focus on the promises that are made to savers in DB schemes and on protecting their pensions from scammers; over the fifteen-year horizon of the strategy, as assets in DC schemes grow, there will be a shift in primary focus to the security and value that these schemes provide savers.
- **Value for money** - savers' money must be well-invested, costs and charges must be reasonable; and good quality, efficient services and administration are driven by robust data.
- **Scrutiny of decision making** - monitoring those who make decisions that impact savers' outcomes, closely scrutinising any decisions that pose a heightened risk to the quality of these outcomes.
- **Embracing innovation** - encourage innovation and good practice, collaborating with the market to enhance security, efficiency, transparency, simplicity, and choice.
- **Bold and innovative regulation** - transforming the way TPR regulates to put the saver at the heart of its work, driving participation in pensions saving and enhancing and protecting savers' outcomes; maintain a sharp focus on bold and innovative regulation, anticipating and preventing issues before they materialise.

The strategy has been published in the form of a discussion paper, with four issues highlighted, and meetings with key stakeholders are planned. The final strategy will be published in 2021 and the strategic priorities will form a core part of TPR's annual three-year corporate planning going forward.

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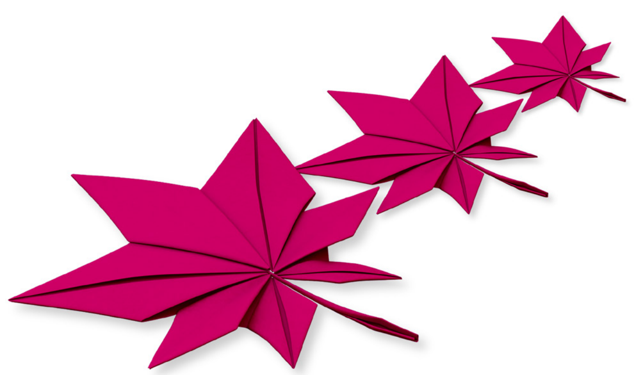
What can we learn from this paper?

Taking each of the above priorities in turn, key points from the discussion paper are –

- There is still much to do for members of DB schemes (including impact of COVID-19, new Funding Code and combatting pension scams) but, as the shift to DC continues, TPR's focus will move from a scheme-based view to one focussed on the saver.
- As we become a nation of 'DC dependents' (individuals who have only ever been in DC schemes), TPR's focus will be on making sure that those schemes are well run and provide value for money.
- TPR expects dashboards and fintech to increase transparency and reduce the cost and effort of making decisions. A shift in the trustee model is predicated, with fewer, more professionalised trustees.
- In future, savers will have longer and more varied working lives and this has an impact on how and when they save for retirement and the products, guidance and advice they will need. Market innovations will require improved data quality but advances in technology should improve both the quality and security of data.
- TPR expects to be regulating fewer but larger schemes of all types as the market consolidates: for occupational DC this could be around 50% fewer schemes and for DB around a third fewer. Also, in 15 years, the UK will be halfway towards its legally binding net zero emissions target and this means all pension schemes' investment decisions will need to take account of climate risk.

ACTION
Look out for meetings with stakeholders and TPR's response to this consultation.

Helpful Links
TPR's Corporate Strategy Discussion Paper



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8 Cyber security guidance

Is your scheme cyber secure?

I was reading a report recently which stated that, along with the rise in internet usage due to the Covid-19 pandemic, cyber security incidents have increased exponentially. Since the beginning of 2020, there have been more than 445 million cyberattacks reported, which is double the 2019 figure.

This is a worrying statistic. For all of us who are trustees of pension schemes, it brings home the need to ensure we have robust Cyber and Information Security Policies in place for each of our schemes and that such policies should be regularly reviewed.

Pension schemes are a source for large quantities of data and assets, which makes them prime targets for fraudsters and criminals.

Guidance published by The Pensions Regulator highlights that all 'pension scheme trustees need to take active steps to protect members and assets against cyber risk'. In addition, the Pensions Administration Standards Association (PASA) recommends that trustees prepare for when a cyber security incident occurs rather than if.

Clearly, it is not possible to remove all risks of a cyber security incident happening. However, I have set out below the recommended steps I believe all pension scheme trustees should consider taking now to significantly reduce the risks.

Ensure an initial risk assessment is carried out

As an initial step, review your current security levels and consider whether there are any weak links in your processes. For example, do the trustees have secure email addresses and secure devices on which they access scheme data? Also, do they have the facility to send confidential information or data securely to recipients?

Is it possible to share trustee meeting packs online, instead of posting them out?

Ensure an incident response plan is in place

It is vital that, in the event of a cyber security attack, the trustees know what steps they would take to deal with it. All remedial actions and decisions would need to be mobilised as quickly as possible. Therefore, it is very important to have a robust response plan in place which details what actions would need to be taken and which personnel would be responsible for taking key decisions.

Review the cyber security policies of the scheme's advisers/suppliers

It is important to fully engage with all of the scheme's third-party suppliers, such as administrators and investment managers, to fully understand what they would do if a cyber security attack were to take place that affected your scheme. They should also have an incident response plan of their own.

In addition, the trustees should review on a regular basis the contracts for third-party suppliers to establish where responsibility for a cyber security breach lies. If this is not covered in the contract, the trustees should consider an amendment to ensure full coverage.

Monitor cyber risk

The trustees should ensure their scheme's cyber risks are regularly reviewed/assessed and include this as a standing item on their meeting agenda, as well as being recorded in the scheme's risk register.

Conduct cyber security training

It is important that the trustees receive regular training on identifying the warning signs of cyber security scams and common preventative measures.

Fail to prepare ...

Unfortunately, cyber attacks are not going to go away – they are much more likely to increase in frequency. Trustees who ignore the dangers do so at their peril, and at risk to their members. We must all give a great deal more focus to protecting our schemes from cyber attacks throughout 2021 and onwards, especially as conducting pension scheme business electronically becomes the new norm!

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9 APPT New Code of Practice for Sole Trustees

Background

In recent years, there has been a steady rise in the number of pension schemes moving from a trustee board model to a sole trustee model. With continuing pension scheme closures and increasing complexity, this trend seems set to continue.

Against this backdrop, The Pensions Regulator has expressed some concerns about certain aspects of the sole trustee model – the potential for bias in decision making, a lack of transparency and the greater risk of potential conflicts of interest arising because of the financial relationship between the sole trustee and the sponsoring employer.

Consequently, the industry body for professional trustees, the Association of Professional Pension Trustees (APPT), with the support of The Pensions Regulator, has recently launched a new code of practice which raises the bar for Professional Corporate Sole Trustees (PCSTs).

What does the new code say?

The new code of practice reinforces the APPT's existing professional standards code (which all accredited professional pension trustees must follow) and sets out additional standards that PCSTs must adhere to in order to ensure that scheme members' interests are properly protected.

PCSTs are expected to ensure that:

- their firms adopt a robust governance framework to manage potential conflicts of interest for PCST appointments and maintain independence from the sponsoring employer
- their firms maintain due diligence procedures around PCST appointments
- measures are in place to document how adviser appointments are made fairly and transparently
- due consideration is given to diversity and inclusion in the decision-making processes (PCST firms are expected to develop written policies on the subject).

Importantly, the controls include a requirement for at least two accredited professional trustees to be involved in the PCST decision-making processes.

Does your sole trustee measure up?

The code is to be welcomed and means that there is now a benchmark against which to measure PCSTs.

Any sponsoring employer that has a sole trustee or is thinking about appointing a sole trustee should look at the governance framework to ensure that it meets the additional standards for PCSTs.

New Code of Practice for Sole Trustees announced – APPT (Association of Professional Pension Trustees)

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10 Reform of RPI

RIP RPI?

In news that has been widely trailed for some time, albeit with uncertainty over timing, the Government will, from 2030, replace the heart of the calculation routine for Retail Prices Index (RPI) inflation with the component parts of its preferred index, Consumer Prices Index including owner occupiers' housing costs (CPIH).

Background

RPI has actually been a poor measure of general inflation, at times greatly overestimating, and at other times understating, changes in prices. In recent years, RPI has been around 1% higher than CPIH, although the difference between the two measures has varied. One of the main reasons for this is an issue with the underlying calculation methodology, which ultimately led to the RPI losing its status as a National Statistic in 2013.

What does it all mean?

For members who have benefits linked to CPI, or do not receive increases, there will be no change. However, members who have all or part of their benefits linked to RPI will see a change in how their pension increases from 2030. Based on recent evidence, annual pension increases could be up to 1% lower.

For pension schemes, there are two aspects to consider - assets and liabilities.

— Assets: Where a scheme has benefits linked to inflation, index-linked gilts have been a popular "matching" investment. Changing RPI to CPIH will result in an expected reduction in future payments received on index-linked gilts, which will have implications for the value of those assets. Schemes that hedge their inflation risk through LDI investment will be similarly affected. The Government has confirmed there will be no compensation for this.

— Liabilities: As there are no CPI-linked government assets, it has been common practice for actuaries to set CPI assumptions relative to market information on long-term expectations for RPI. Prior to the consultation, it was common to assume that the long-term gap between RPI and CPI rates would be around 1% a year. With RPI effectively reducing from 2030 and CPI unchanged, the gap between RPI and CPI will narrow. As such, actuaries will revisit their CPI assumptions to ensure these are not too low (which, if left unchecked, would lead to an understatement of liability values).

However, we should not forget the positives. The greater certainty should help those schemes who might be looking at buy-ins and buy-outs; while schemes with CPI-linked benefits will find there are now long-term assets that are more closely aligned with these benefits.

ACTION

The following are the key takeaways for trustees:

— Engage with Scheme Actuary around whether changes are required to the Transfer Value basis, the cash commutation factors and any other factors.

— Engage with Scheme Actuary on the implications for the actuarial valuation.

— Engage with investment advisers on implications for the investment strategy, notably to refine liability hedging portfolios where necessary.

— Consider what might be communicated to members at this stage.

Helpful Links

Consultation outcome - A letter from Rishi Sunak to Sir David Norgrove (23 October 2020)

A Response to the Consultation on the Reform to Retail Prices Index (RPI) Methodology

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11 DB Superfunds - guidance for trustees

Following earlier guidance for defined benefit ('DB') Superfunds, The Pensions Regulator ('TPR') has released guidance for trustees and employers considering a transfer to a DB superfund in October.

As anticipated, the guidance is framed around "gateway" principles that trustees need to consider before authorising a bulk transfer of their scheme's assets and liabilities to a Superfund. The three principles are:

- The scheme cannot afford to buy out with a regulated insurance company now.
- The scheme cannot afford to buy out in the foreseeable future.
- The transfer improves the likelihood of members receiving full benefits.

Guidance for trustees

From a trustee perspective, we should treat transfers to a Superfund as potential "Type A" events, i.e. events that could have a materially detrimental impact. tPR expects Clearance applications for proposed transfers, in particular in the short term, and trustees are expected to review any prior events that could have been materially detrimental and to revisit whether mitigation should have been provided at the time.

The key expectation from tPR is that we should carry out thorough due diligence on the proposed Superfund transaction, including the financial position of the Superfund and their future plans. We should also obtain professional advice when considering and undertaking a transfer to a superfund, which should include actuarial, covenant and legal advice.

Given the complexity of the decision, we should also consider whether the trustee board has the necessary knowledge to make the decision and, if not, should consider appointing an independent trustee. The points that TPR expects trustees to consider are:

- Other options to improve the scheme's position, for example additional funding or security provided by companies related to the sponsor(s).
- Whether the superfund is the right place for members given their circumstances, noting the gateway tests in particular.
- tPR's assessment of the superfund, which should be available via their website "shortly" (DB superfunds list and assessment | The Pensions Regulator).
- How the superfund will operate including issues such as funding, investment strategy and fees.
- Whether conflicts of interest are appropriately managed. This covers not only the usual conflicts but also the situation where the same professional trustee company acts for both the transferring scheme and the receiving Superfund.
- Whether the trustees and their advisers are comfortable with the results of any modelling carried out.
- Whether the transfer is in line with the gateway tests. While the first test is quite easy to assess, the second and third are far more subjective and involve very detailed modelling of outcomes over an extended period, considering a range of investment outcomes and the complex interaction between scheme benefits (before an insolvency event of unknown timing) and PPF compensation (after an insolvency event).
- Any risks created by the transfer for either transferring or remaining members in the scheme.

In addition to the due diligence, Trustees should engage with TPR early in the process if analysis suggests that a superfund could be the right option for the scheme. Consideration also needs to be given to communications with members – they should be open and transparent as well as clear, accurate and jargon free.

Helpful Links

DB superfunds | The Pensions Regulator

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12 Post Brexit impact on pension schemes

Overview

At the end of year, the UK reached an agreement with the EU over the terms of its future trading relationship, with the deal being governed under the EU – UK Trade and Corporation Agreement (TCA). TCA, which became effective from January, provides tariff and quota free trade on goods, with little commitment on services.

The full impact on Government, business and in turn pension schemes will take time to understand, below are some of the key points likely to impact on pension schemes and their stakeholders.

Legal changes Under the EU (Withdrawal) Act 2018, relevant EU law was retained in the UK. However, in the future, the UK may diverge, with EU Court of Justice decisions no longer being binding on UK Courts. In the short run, material changes to UK pension rules are not expected.

Investment Before agreement was reached, uncertainty over the Brexit negotiations had contributed to significant market volatility. It is hoped that the trade deal will increase stability. The impact of the deal and any future agreements on asset values will need to be monitored closely.

Impact on sponsor Changes to the trading relationship may impact sponsors in a number of ways including any new barriers to trade, changes to the labour market, and short and long term changes to the value of sterling. Sponsors will need to assess the impact of the changing trading relationship, including the development of any bilateral agreements with trading partners outside of the EU.

Funding The economic impact of changes to trading relationships and market volatility may impact on scheme funding levels, possibly triggering contingency payments. The impact on the employer should be considered by the Trustees in such a scenario.

Impact on members residing in the EU Prior to the end of the year, some UK banks were closing the bank accounts of EU residents. Any pensioner members living in the EU who previously received their pension into a UK bank account, may be required to have their pension paid into an alternative account. To date we have not experienced a significant number of queries on this matter from the pensioners we pay within the EU.

Data Although TCA does not address data, it did provide a four month window, allowing UK companies to continue to not being treated as a third party for GDPR purposes. This window can potentially be extended to six months. The Information Commissioner Office has confirmed that data can continue to be sent and received during this period.

ACTION

- Trustees should obtain updated advice on the impact of TCA on their schemes investment strategy.
- Trustees will need to engage with sponsors to consider the impact of any changing trade relationship, and the steps taken by the sponsor to address any short and longer term disruption to the business.
- With regards to EU residing pensioners, many of the schemes we administer decided to write to any affected members at the end of 2020 and enquire whether they require their bank details to be changed. Any such queries over the next few months will be prioritised in order to avoid or minimise any potential disruption to pension payments.
- Any developments with regards regulations with regards to data transmission with the EU should be monitored.

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13 Coming up Next...in 2021

As we start the new year we thought we'd look ahead to what we can expect over this coming year. With many things put on hold in 2020 due to the Covid-19 pandemic and Brexit, one thing for certain is that 2021 is set to be a very busy year!

- Pensions Schemes Bill 2019-21 – The natural place to start is with the Pensions Schemes Bill, which is going to have a significant impact on the pensions industry in 2021 and way beyond. In summary the Bill sets out:
  - Strengthened powers for The Pensions Regulator (TPR);
  - Changes to the funding regime for defined benefit schemes;
  - A new requirement for climate responsible investing;
  - The statutory framework that will underpin collective defined contribution schemes and
  - A framework for pensions dashboards.
- The Bill will also strengthen the rules on DB transfers clarifying how the statutory right to a transfer might be denied by trustees if certain "red flags" are identified (as discussed earlier in this report).
- It is also worth mentioning that the Pensions Minister has promised a second Pensions Bill that will put in place a legislative regime for DB superfunds. So, 2021 could well be the year of the first successful superfund transaction.
- 'Target End States' for DB Schemes – The Institute and Faculty of Actuaries ("IFOA") recently released a paper setting out the issues to be considered by trustees, employers and their advisers when setting the 'Target End State' ("TES") for their scheme. The Pensions Schemes Bill will introduce a requirement for trustees to set a long-term, integrated strategy (i.e. funding and investment) for how the scheme can reach its TES and articulate this in their triennial actuarial valuations. The IFOA's paper sets out the issues to be addressed when deciding whether the TES should be low-dependency, buyout, or transfer to a superfund, with member outcome analysis being identified as a central tool in this decision making. A 5-step approach is set out, with further advice on the role of the actuary, how trustees should review their TES and the importance of preparing data and benefit tasks. While little focus has been placed on setting a TES in the past, it seems 2021 will push the topic to the forefront for DB scheme trustees and sponsors.
- A new funding regime for defined benefit pension schemes - TPR's Funding Code Consultation, Part II – The interim response from TPR to the first stage of its revised DB funding code consultation was published recently. General support for the principles in the funding code was expressed, but TPR recognised that the 127 responses to the consultation did raise concerns as to how those "principles would be applied in practice through the twin-track regime (Fast Track and Bespoke)". The second half of 2021 will therefore see the next stage of the funding code consultation, which will include a summary of the first round of responses, a draft code of practice for consultation, and an impact assessment of the proposals.
- Increased focus on ESG and climate responsible investing – 2020 saw the implementation of many new requirements under the CMA Order - the online publication of Statements of Investment Principles, the preparation of annual Implementation Statements and the submission of Compliance Statements to the CMA. 2021 will see further requirements in relation to trustee investment and governance duties and an increasing focus on climate responsible investing. As of 1 October 2021, large pension schemes (in excess of £1 billion of assets), authorised master trusts and collective money purchase schemes will need to have in place their climate risk governance measures and publish climate risk disclosures. In addition to these reporting requirements, The Pensions Climate Risk Industry Group has also published non statutory guidance for trustees of occupational pension scheme on assessing, managing and reporting climate related risks. This guidance is likely to come into force in early 2021.

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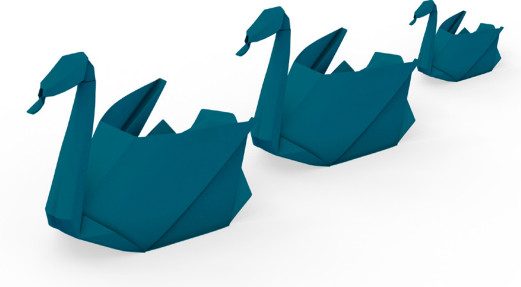
- Scheme governance – Introduction of a Single Code of Practice - 2021 is also likely to see a fundamental change to TPR's codes of practice, with the roll out of a single, shorter code (with the DC code and the internal controls codes first in line to be reviewed). There are currently 15 codes of practice providing practical guidance on how to comply with pensions legislation and examples of the conduct expected by TPR. Formal consultation is expected in early 2021 with the aim being to produce an updated single code by the end of 2021/ beginning of 2022. Trustees will need to take the time to familiarise themselves with the new code and will need to be able to demonstrate to TPR that they have an effective system of governance within 12 months of publication of the updated code.
- Pension Scams – Our earlier article detailed the efforts being made by TPR to tackle pension scams, with the pledge to combat scams being front and centre. We expect 2021 to bring a much welcomed, and much needed, tougher stance on preventing scams, with ceding schemes in particular being expected to implement tougher due diligence when it comes to member transfer requests.

As noted above, while there is much to look out for in our industry in the weeks and months ahead, let us continue to look out for each other, and to that end, we at Dalriada wish you well in this coming year. All of us sincerely hope that 2021 represents a much more enjoyable and "normal" year than the one we just navigated, and we look forward to working with you through whatever challenges lie ahead.



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