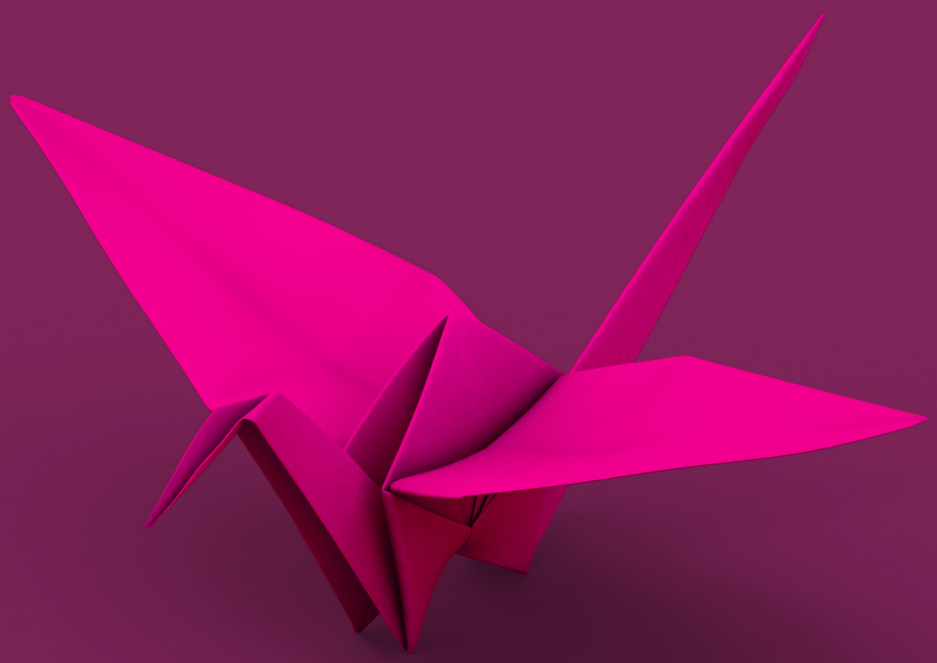
Your Quarterly Pensions Update

Dalriada Trustees - Industry Changes

Quarter 1 2021



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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 Pension Schemes Act 2021 - Climate Change

Last year saw a number of schemes publish their first round of implementation statements and legislators have continued to push forward their agenda on Environment, Social and Governance (ESG) initiatives. Earlier this year the DWP published a guide on aligning pension schemes with the Taskforce on Climate-Related Financial Disclosures (TCFD) recommendations. At the same time, it consulted on proposals requiring schemes to address climate change risks. The Pension Schemes Act 2021 received Royal Assent in February and, when the responses of the consultation on climate change risk have been reviewed, the final regulations will be made under this Act, sometime this summer.

"The UK is set to become the first major economy to require climate risks to be specifically considered and then reported on by pension schemes. Together, we can build a better, safer and greener pensions system" - Guy Opperman, the Minister for Pensions.

The proposals will require TCFD disclosures to be published in the annual report as follows:

- From October 2021, schemes with £5bn or more assets, authorised master trusts and collective money purchase schemes.
- From October 2022, schemes with £1bn or more assets.

Insured annuity contracts are not considered relevant assets for the above purposes. Requirements for smaller schemes will be reviewed in 2024.

The TPR has also published its Climate Change Strategy recently. David Fairs, TPR's Executive Director of Regulatory Policy, Analysis and Advice has said

"Our strategy outlines how we will help trustees comply with the new rules for larger schemes, but it signals work on climate change needs to happen right across the pensions landscape - climate change is a risk for schemes whatever the size or investment strategy. It is clear that all schemes need to build their capacity in this area if they haven't already."

All of the above publications are focused on climate change risk, but trustees should not forget about the other areas of ESG. DWP has launched a call for evidence on the Social element of ESG investing which *"seeks views on the effectiveness of occupational pension scheme trustees' current policies and practices in relation to social factors".*

Minister for Pensions Guy Opperman, launching the Call for Evidence, said

"I'm proud of the progress we have made in bringing environmental and climate issues up the pensions agenda, but climate change should not be trustees' sole consideration. Financially material social factors also pose risks to schemes' investments".

ACTIONS FOR TRUSTEES

- Is the scheme in scope of the draft regulations and, if so, when?
- Do we as trustees need training?
- What data will be needed?
- How will investment strategies, processes, monitoring and reporting change?
- What steps need to be taken to align with the TCFD recommendations?

Helpful Links

Aligning your pension scheme with the TCFD recommendations - GOV.UK

Taking action on climate risk - Response and Consultation on regulations - GOV.UK

Climate change strategy | The Pensions Regulator

Consideration of social risks and opportunities by occupational pension schemes - GOV.UK

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3 Pension Schemes Act 2021 'in practice'

News on Regulations and What you should be doing now

Although the latest Pension Schemes Act ("the Act") only received Royal Assent in January (it was, in fact, the first Act of Parliament of 2021), it has been two years in the making and readers will already be familiar with the substantive provisions, and are probably equally aware that implementation is dependent on regulations that are not expected to enter into force until at least Autumn 2021.

WHAT NEWS HAS THERE BEEN ON THE REGULATIONS?

New Criminal Powers for The Pensions Regulator ("TPR")

TPR has published its draft policy and a consultation on how it plans to use its new criminal powers under the Act to investigate and prosecute those who avoid employer debt regulations or put savers' pensions at risk. The offences are both punishable by up to seven years in prison and/or an unlimited fine, albeit they are not expected to be in force until Autumn 2021.

The consultation is relevant to both trustees and employers and, given the potential ambit of TPR's powers, anyone else involved with defined benefit (DB) schemes too.

Concerns have been raised to date about the new powers, with a feeling that the criminal offences have been drafted widely and there could be an impact on legitimate corporate activity. The key points from the draft policy to note are:

- TPR's expectation is that the offences should not change commercial norms or accepted standards of corporate behaviour in the UK. Rather, they are aimed at more serious intentional or reckless conduct.
- There is no limitation period for these powers.
- TPR says evidence pre-dating the commencement date of the new powers "may be relevant" to their investigations (despite the Pensions Minister previously stating that the new criminal offences would not be retrospective).
- The draft policy includes examples of what could trigger action under the offences and what could be termed as a "reasonable excuse" defence.
- TPR expects the basis for the reasonable excuse to be clear from contemporaneous records such as minutes of meetings, correspondence and written advice. Importantly, TPR recognises that a party can have regard to its own interests. The burden of proof will be on the prosecution to prove the absence of a reasonable excuse (i.e. TPR would have to prove that a person had intent or "knew or ought to have known" what they were doing).
- In terms of when TPR is likely to prosecute, factors include whether the parties have complied with the notifiable events regime and the openness and timeliness of communication with TPR.

Contribution Notice Regulations

The Department for Work and Pensions ("DWP") has published a consultation seeking views on draft regulations relating to the "employer resources test". The regulations will provide an alternative test, which will work alongside the existing regime, to assess whether an act or failure to act has occurred for determining whether a section 38 Contribution Notice can be issued. The new section 38E also includes regulation making powers to prescribe how the resources of a sponsoring employer are to be determined.

Information Gathering Powers for TPR

As part of the consultation, DWP is also seeking views on the draft regulations enabling TPR to ask for any relevant information or documents, from any time in the past, during an interview or inspection. However, how TPR uses the material obtained will be subject to the admissibility of evidence provisions and, where relevant, the date that legislative provisions or offences came into force.

Where there is non-compliance with information gathering requests, the draft regulations provide for fixed and escalating penalties, with a higher level of escalating penalty applying to those entities that are not individuals.

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What should trustees and employers be doing now?

We summarised the key changes in the Act in various Quarterly Updates during 2020 and have, therefore, decided that subject to an aide-memoire at the end of this article, there is little utility in repeating them here.

Though, what we have done, is set out below our views on what actions trustees and employers can usefully do now in advance of the new requirements coming into full effect. Given the potential sanctions for non-compliance with some requirements, we make no apologies for the focus on 'education'.

NEW POWERS FOR TPR: CONTRIBUTIONS NOTICES

Actions for trustees

- Be prepared for employers being more likely to seek clearance for future transactions, including transactions before the new requirements become law, resulting in greater trustee involvement

Actions for employers

- Keep the trustees informed of any proposed transactions that might impact the pension scheme; consider information sharing and confidentiality agreements with trustees

New criminal penalties

Actions for trustees

- Update risk registers
- Consider training for the trustee board on TPR's new powers
- Take advice and maintain a clear audit trail of all decisions
- Have a standing agenda item to specifically consider whether any proposed actions at a trustee meeting might constitute "conduct risking accrued scheme benefits"
- Make sure scheme administrators have these new offences on their radar
- Check indemnities and insurance policies

Actions for employers

- Make sure that all officers/employees who take decisions on behalf of the employer are aware of the new criminal offences
- Consider training for senior management
- Check directors' and officers' indemnity insurance
- Consider appointment of a professional trustee

Notifiable Events and accompanying Statement

Actions for trustees

- Become familiar with the new notifiable events regime
- Consider training
- Update the trustees' notifiable events framework
- Update risk registers
- Check insurance and indemnities

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Actions for employers

- Make sure that all officers/employees who take decisions on behalf of the employer are aware of the changes
- Consider training for senior management
- Check insurance policies

Inspection and Interview Powers

Actions for trustees and employers

- Consider appropriate training

Scheme Funding

Actions for trustees and employers

- Open a dialogue

Climate Change

Actions for trustees

- Check whether the scheme will be in scope of the regulations
- Consider compliance as 'best practice' even if scheme not in scope
- Consider trustee training

Actions for employers

- Find out what actions the trustees intend to take and consider alignment with the employer's own measure

Dashboard

Actions for Trustees

- Consider putting in place data management plan

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Pension Schemes Act 2021: An 'aide-memoire'

Collective DC

- Legislative framework for new type of pension scheme design

TPR

- Five new criminal offences, in particular "behaviour that seeks to avoid s75 debt" and "conduct that puts accrued scheme benefits at risk"
- Up to seven years imprisonment and unlimited fines for criminal offences
- Separately TPR can impose fines of up to £1m
- Changes to notifiable events and requirement for declaration of intent regarding corporate transactions
- Two new contribution notice triggers – "act that materially reduces s75 debt" and "act that reduces employers resources relative to s75 debt"

Funding

- Legislative framework for new funding regime
- Act to be supplemented by regulations and new Funding Code (consultation in second half of 2021)
- Funding and investment strategy in written form ('chair statement' for DB schemes)
- Trustees need to think about long-term objective

Climate Change

- Public disclosure of a pension scheme's green credentials
- Detail in regulations – draft already issued for consultation
- Phased introduction {Big (>£1 billion) schemes first; smaller schemes likely to be in scope after review in 2023}

Transfer Values

- Changes to statutory transfer right where there are 'red flags'
- Regulations expected second half of 2021
- Commencement

ACTIONS
Pension Schemes Act 2021 (legislation.gov.uk)
TPR consults on new criminal sanctions policy | The Pensions Regulator
Aligning your pension scheme with the TCFD recommendations - GOV.UK
Taking action on climate risk - Response and Consultation on regulations - GOV.UK

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4 Investment Update

During the first quarter of 2021, global equity markets continued to post gains, climbing around 4%, as investor optimism increased. The pace and success of the vaccine rollout programs in the US and, particularly the UK, coupled with the confirmation of a $1.9 trillion fiscal stimulus package in the US, were the prime reasons for the increased optimism in the market. However, bond yields materially rose over the period (meaning prices fell) as expectations for improving economic growth and higher inflation put pressure on yields.

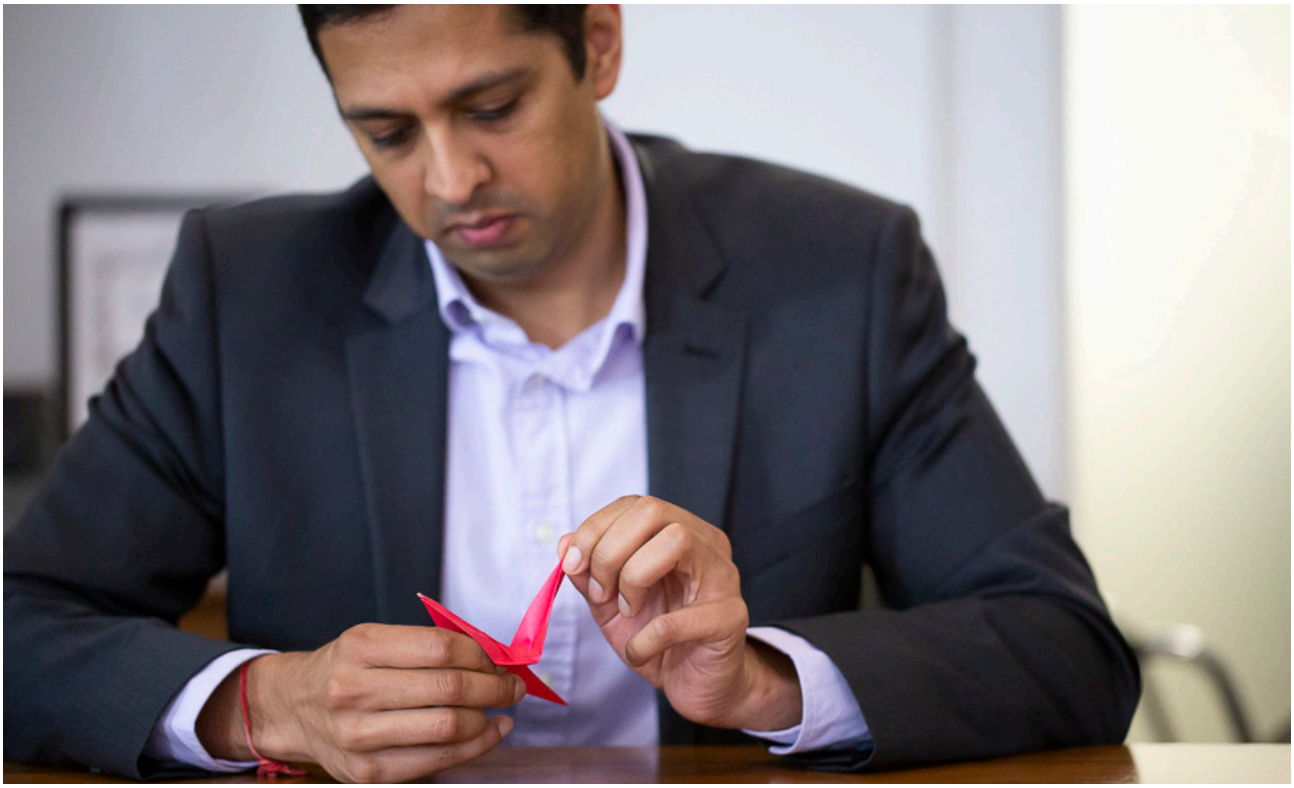
UK equities performed well over the quarter, up around 5%, as economic conditions improved. Sectors which previously underperformed due to the Covid-19 pandemic saw the highest increase over the most recent quarter. Banks performed well due to better-than-expected earnings and the sharp increase in bond yields. Energy stocks also increased due to a rise in commodity prices.

US equities increased by approximately 5% over the quarter, driven by the Democrat's victory in the State of Georgia in January, which provided them with a (slim) majority in the US Senate and paved the way for a further US fiscal stimulus worth 9% of US GDP. President Biden also announced a $2 trillion infrastructure package, which he intends to pass later this year. Investor sentiment also rose as the unemployment rate declined by more than expected, while the Federal Reserve increased its growth outlook.

Emerging market equities finished the quarter higher, by about 1%, despite lower vaccination rates and increasing Covid-19 cases in countries such as Brazil and India. Chinese equities declined over the period, due to concerns about moderate policy tightening weighing on investor sentiment.

Investment grade corporate bonds posted losses in the first quarter of the year, as yields increased, while high-yield bonds had a small positive return as the risk appetite of investors increased in line with the improvement in economic conditions.

Government bond yields rose over the period (i.e. prices fell) with commonly held views that stronger growth and higher inflation expectations would force central banks to increase rates earlier than expected. For example, the 10-year US Treasury yield increased from 0.91% to 1.75% and the 10-year UK gilt yield increased from 0.23% to 0.93%.



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5 Target End States for Defined Benefit Schemes

Since the late 1990s, when the transition from DB to DC as the primary basis of pension provision begun, most UK based DB schemes have been moving towards the endgame.

Once a scheme is closed to new entrants and/or accrual it is inevitable that the scheme will mature, its active and deferred population will decrease and its pensioner population will increase. The scheme moves out of collective accumulation and into collective decumulation and just like in an individual DC pot there is a need to reduce risk and protect the ability to pay pensions as the fall due. How quickly that risk is reduced and what your "Endstate" looks like depends completely on the Integrated Risk Management triangle – How well funded are you? How much can the sponsor(s) afford to pay while keeping the business healthy? How much investment risk can the sponsor(s) afford to underwrite and are the trustees willing to take?

Are you paying the right benefits, to the right people at the right time?

The fundamental duty of all trustees becomes increasingly important as we move through the endgame. Whilst essential at all times, the need to properly know your liabilities becomes ever more important before errors are crystallised or we run out of time to correct funding mismatching. The first step is to draw up a definitive schedule of the benefits (a benefit specification) provided under the rules with legal sign off and audit the scheme data against that specification – the sooner you do this, the easier, and less expensive, it normally is.

CORE PRINCIPLES

The report from the Institute and Faculty of Actuaries sponsored working party issued in January of this year considered these points. Cognisant of the fact that this is exactly the impetus for the imminent regulations around long-term objectives and integrated funding and investment strategies, the report considers the roles of the various stakeholders in this process and the key considerations. The report identifies some core principles that the industry is waking up to, including:

- There is not a one-size-fits-all Endstate; buy-out and wind up need not be everyone's goal; consolidation or self-sufficient run off can be options.
- The majority of schemes are small so all solutions have to be scalable and proportionate.
- The trustee role changes, so it is important that trustees understand their duties and have the knowledge and understanding collectively to lead their scheme to its Endstate.
- The role of the adviser evolves as you move through the endgame, so you may need a different actuary/lawyer/investment consultant if they don't evolve with the needs of the scheme.

ACTIONS

- Trustees and sponsors work together to understand their options and the best fit Endstate
- Make sure that the solution is trustee-led and that all stakeholders are aligned
- Get Endstate ready – be sure of your liabilities

Helpful Links

Sessional webinar end-game and beyond

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6 The Uber Case: Disrupting the Disrupter

A relatively new free market system that uses a slang word normally associated with musicians may not be as harmonious as it might first sound. Typically, the "gig economy" thrives to a large extent on temporary positions, where organisations hire independent, self-employed people for short-term commitments.

Uber is one such organisation operating in this free market system. It sees itself as a "disruptor" amongst the traditional taxi industry. This case was the culmination of a five-year legal battle that started in the Employment Tribunal (ET) and went all the way to the Court of Appeal. Uber said that its taxi drivers were not workers but self-employed, claiming it acted merely as a booking agent. The taxi drivers argued that they were "workers" under UK employment law. Establishing worker status is a prerequisite for a number of rights, including minimum wage, holiday pay, sick and pension benefits. The Supreme Court (SC) has now had the final word on the matter and has agreed with the taxi drivers, by unanimously upholding the Court of Appeal decision.

Broadly, the facts of the case were that Uber owns and operates a smartphone app through which customers order a private hire vehicle and pay the fare. Uber's position was that it is a technology platform facilitating the provision of transportation services; it does not provide those services itself. The transportation services are provided by the drivers. A contract is concluded between driver and passenger for each ride. The drivers were self-employed and Uber was merely a booking agent. All drivers had to have a private hire vehicle operator licence. Uber has complex contractual documentation purporting to create the above arrangements, although there is no written agreement between Uber and drivers. Any written terms between Uber and its drivers are entered into with UBV (Dutch Parent Company). The nub of the issue was that Uber had sought to define "worker" in their contracts so as to avoid the inconvenience of the definition of "worker" in the Employment Rights Act (ERA).

The matter was appealed each time by Uber until it reached the SC. The SC said that the contract was not the starting point to define who is a "worker". To do so would allow Uber to reinstate the mischief which the legislation was enacted to prevent. In other words, Uber cannot arrogate to itself the power of determining whether legislation designed to protect workers would apply to its drivers. The ERA deliberately provides a wide definition of "worker" because it aims to include as many people in that category as possible.

The SC unanimously dismissed the appeal and held that Uber is not a booking agent for drivers and that Uber drivers satisfy the definition of worker under the ERA. The SC identified several factors that undermined the fact that they were self-employed such as: working time starts when drivers log on the app, Uber sets the fares, the delivery of service does not allow the driver to build a customer base, and Uber decides on full or partial refunds. The true agreement is not gleaned from the specific contract but from all the other circumstances of the case, of which the written contract is only a part. Finally, the contract needs to take into account the purpose of the legislation.

ACTIONS

The SC judgment effectively signals the end of the road for bogus self-employment and has far reaching consequences for the gig economy. The implications are obvious for employers operating on similar business models. As workers under employment legislation, it is likely that the drivers would also be eligible jobholders under the Pensions Act 2008 and qualify for auto-enrolment, subject to the relevant age and earnings criteria.

The case will now be referred back to the ET to determine the merits of the claim and how to compensate the drivers. In the interim, Uber has announced it will give basic employment protections to its UK private hire drivers, meaning that some 70,000 drivers will have access to holiday pay and a pension scheme, as well as entitlement to be paid at least the national living wage.

Helpful Links

Uber BV and others (Appellants) v Aslam and others (Respondents) (supremecourt.uk)

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7 PASA Guidance

Guidance note on tax issues

The Guaranteed Minimum Pension (GMP) equalisation working group, chaired by the Pension Administration Standards Association (PASA), has issued further 'good practice' guidance for UK pension schemes.

The latest Guidance highlights tax issues that schemes may encounter in adjusting benefits for GMP inequalities (GMPE) and identifies possible approaches for dealing with those issues.

The guidance contains 16 'key messages' and also includes examples; information on technical issues such as the various forms of HMRC protection and their interaction with GMPE; and template communications.

PASA point out that the Guidance is not a definitive guide to the issues, nor is it a substitute for professional advice. Therefore it is recommended employers and trustees work collaboratively, involving scheme administrators and advisers as appropriate.

The guidance is light on the topic of GMPE and 'conversion', but there are too many 'known unknowns'; some of which it may only be possible to resolve through legislation.

Further guidance on conversion should be available soon.

Guidance note on Data Management Plans

PASA has launched its new Data Management Plan (DMP) Guidance in conjunction with PASA Expert Knowledge Provider for Data, Deloitte.

This Guidance sets out, at a high level, the purpose of a DMP and the information a DMP may be expected to include. It also covers the importance of data security.

It is becoming more and more critical for data to be complete and accurate for a scheme to meet all of its obligations, whether that be to pay members the right benefits at the right time, dashboard readiness, GMP equalisation, liability management exercises and eventual buy out of benefits.

A DMP is a critical scheme document and forms part of good scheme governance. Its implementation offers a means of documenting the data held by a pension scheme and a policy for managing it effectively. The information in the DMP should be integrated with the approach trustees are taking in respect of data as part of their wider risk management framework.

ACTIONS FOR TRUSTEES
Consider both guidance notes when equalising GMPs, and considering wider data and risk management requirements, respectively.

Helpful Links
PASA GMP Equalisation - Guidance on tax issues
PASA - Data management plan guidance

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8 What's happening in DC?

Current and prospective developments for defined contribution schemes

AUTOMATIC ENROLMENT (EARNINGS TRIGGER AND QUALIFYING EARNINGS BAND) ORDER 2021

Under this statutory instrument, the upper end of the qualifying earnings band for automatic enrolment into a qualifying pension scheme will rise to £50,270 (from £50,000 last year) and the lower end of the band will remain at £6,240. No changes are made to the earnings trigger, which will remain fixed at £10,000.

Automatic Enrolment thresholds	Trigger	Qualifying earnings band, lower limit	Qualifying earnings band, upper limit
2020/21	£10,000	£6,240	£50,000
2021/22	£10,000	£6,240	£50,270

INCORPORATING PERFORMANCE FEES WITHIN THE CHARGE CAP: A CONSULTATION

This consultation document from the Department for Work and Pensions (DWP), the next step to its earlier consultation 'Improving outcomes for members of defined contribution schemes', includes:

- a Government response to Chapter 3 of the 'Improving outcomes for member of DC schemes' consultation ('diversification, performance fees and the default fund charge cap');
- regulations to introduce flexibility and innovation for DC schemes when they come to comply with the default arrangement charge cap;
- wider questions on the incorporation of private equity in a DC default arrangement and barriers thereto; and
- discussion on the issue of "look-through" in relation to charge-cap compliance.

The consultation was trailed in Budget 2021 and the clear policy intent can be gleaned from the ministerial foreword –

"I am bringing forward draft regulations, building on the policy proposed previously by the government, which would allow schemes to smooth the incurrence of performance fees, which are often payable on illiquid investments, over 5 years. The hope is that this will give trustees, especially those who might be unsure about investing in illiquid assets, greater confidence to make that leap, safe in the knowledge that they can deliver the best possible return for their members."

PROPOSED CHANGES TO REGULATIONS

Given that the consensus emerging from the 'Improving outcomes' consultation was that introducing the option of smoothing performance fee payments over multiple years would reduce the risk of a charge cap breach and could increase investment in illiquid assets, the government is bringing forward regulations. The latest consultation now focusses on a proposed change to regulations to permit trustees to take advantage of the option of a multi-year smoothing method for performance fees.

The policy intent is to supplement the two existing permitted methods for calculation of the scheme's charges regime with an option to include a 5-year moving average for performance fees as an alternative to the in-year performance fees accrued. Illustrative examples have been developed to demonstrate how a multiple year smoothing approach would work in practice.

'LOOK THROUGH'

The government has developed a position on look-through, which sits in statutory guidance on charge cap compliance (as a reminder, the charge cap for schemes used for automatic enrolment is currently 0.75%). It is now seeking views on its position, via a call for evidence, as to whether the current position acts as a significant barrier to investment in alternative asset classes, particularly venture capital and growth equity and, if so, what solutions should be considered. (The current position is that trustees of occupational DC pension schemes should 'look-through' any fund of funds or pooled investment vehicles, no matter the type of funds such vehicles invest in.)

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The deadline for this consultation is 16 April 2021 at 11:45pm. The Government aims to publish a response to this consultation alongside a response to the remainder of the September 2020 consultation, including final draft regulations and final statutory guidance, in June 2021. The intention is to then introduce the changes from October 2021.

VALUE FOR MEMBERS (VFM)

Following its February 2019 consultation, the Department for Work and Pensions (DWP) has also published the Government's response to: Investment Innovation and Future Consolidation. This prospectively requires the trustees to report annually on:

- Investments of default and member selected funds.
- For schemes with assets below £100 million, how the scheme presents Value for Members (VfM), in respect of costs and charges, investment returns, governance and administration.
- This VfM assessment is against a minimum of three large schemes (with £100 million or more of total assets) on the same factors.
- For schemes that do not present VfM, trustees must report this outcome in the Regulator's scheme return and the default position will be for the scheme to wind up, and for the assets and liabilities to be consolidated into a larger scheme.

The current intention is to also implement these changes from October 2021.

Effective system of governance

In January 2019, the Pensions Act 2004 was supplemented by SI 2018 / 1103, which requires the trustees to operate an effective system of governance. This instrument also requires an Own-Risk Assessment and Internal Evaluation to be completed within approximately 12 months of The Pension Regulator's Code of Practice 9 being updated. The update has been delayed, owing to COVID-19 among other factors, although it is now included in the Regulator's new single super code, on which the Regulator is now consulting. The expectation is therefore that the new code will be published in 2021, requiring the new Own-Risk Assessment and Internal Evaluation in 2022.

The new VfM, Own-Risk Assessment and Internal Evaluation requirements will need to be included in the trustees' Annual Event Calendar and the additional costs for completion incorporated into the scheme's budget.

Helpful Links

The Automatic Enrolment (Earnings Trigger and Qualifying Earnings Band) Order 2021 (legislation.gov.uk)

Uber BV and others (Appellants) v Aslam and others (Respondents) (bailii.org)

Incorporating performance fees within the charge cap - GOV.UK (www.gov.uk)

The charge cap: guidance for trustees and managers of occupational schemes - GOV.UK (www.gov.uk)

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9 Trustee Decision Making

New research and recommendations for improved outcomes

INTRODUCTION

To date, there has been little research into how trustees make decisions. However, given the importance of trustee decision making (think of all the members who are affected by trustees' decisions), it's a topic that's ripe for research and of wide interest to trustees, sponsoring employers, advisors and members.

In January 2021, the Institute and Faculty of Actuaries published a report exploring trustee decision making. The report presents the findings of a behavioural finance research programme which used a combination of qualitative and quantitative research techniques to explore the potential biases that may be present in trustee decision making. Not only does the report provide a fascinating insight into the process, it helpfully offers lots of practical suggestions for improving decision making.

KEY FINDINGS OF THE REPORT

Results of qualitative research

The qualitative research examined the social and cultural context for decision making within trustee boards to help understand how decision biases might be formed. Three distinct characteristics of trustee decision making were the focus for this initial investigation:

- **Group decision making** – Recognising that trustees make decisions as a group. The studies on group decision making show that, contrary to what we might expect, group decision making can lead to poorer outcomes, with fewer ideas generated because information is not shared amongst the group.

  Overall, the customs and practices of decision making in the trustee context support the argument that there are a number of factors that can be regarded as sub-optimal. These are specifically around (i) the large amount of information presented to trustees by advisors and the resulting cognitive overload; (ii) the conduct of trustee meetings - in particular, the use of consensus decision making processes, (iii) the desire for consensus being further strengthened by the relative homogeneity of trustee demographics and the influential nature of the chair of trustees.

- **Judge-advisor systems** - Recognising that advisors are extremely influential in the decision making process, the focus was on the concept of judge-advisor systems (with trustees being the judges in the relationship). "Studies have shown that in general judges are significantly more receptive to paid advice than to free advice". The qualitative research found evidence of trustees showing considerable deference to their advisors and an awareness of the cost of the advice.

- **Surrogate decision makers** – Recognising that trustees are making decisions for others (members), the focus was on the concept of surrogate decision making. The research found that the overlap between trustees' and members' preferences and attitudes is likely to be small due to the difference in profile between the two groups – with trustees typically being older and more wealthy than the members that they are making decisions on behalf of.

Here, the focus was on certain biases within decision making and understanding if they present themselves in trustee decision making. The research covered 'naive diversification' (diversifying pension assets naively), 'framing' (labelling of options), surrogate decision making and fund selection criteria, where it was shown that the layout of the 'menu of choices' presented can influence how information is prioritised.

Empirical results showed that, when setting the acceptable level of pension replacement income, trustees projected their own preferences instead of reflecting member preferences. As a result, trustees chose significantly higher pension replacement rates for members than members chose for themselves.

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Recommendations

The 60+ page report provides a lot of food for thought.

The research adds weight to other calls for greater professionalism in the way that trustees work, finding that member-nominated trustees showed the strongest biases, with the weakest bias being amongst professional trustees.

If acted upon, the report has the potential to change the way in which advisors interact with trustees, with some good suggestions on how advisors can help trustees to avoid 'cognitive over load'.

Trustees and employers may wish to consider the following areas:

Recruitment

- Employing a higher percentage of professional trustees
- Applying more stringent requirements for selecting prospective trustees
- Reviewing the diversity of the trustee board

Further training on the following topics:

- Behavioural biases
- Different decision making styles and techniques
- How to challenge advisors
- Diversity and Inclusion

Reviewing how decisions are made

- For major decisions one trustee could be designated to act in a 'devil's advocate' role
- Consider whether it might be appropriate to introduce voting for some decisions
- For some decisions trustees could be asked to give their view in advance of the meeting

Relationship with advisors

- Trustees may wish to discuss the IFoA's findings with their advisors. In the report there was guidance for advisors and fund managers on to how to present information in a more 'user-friendly' way. The report also recommended that trustees receive information before advice is given to avoid being biased by early information.
- Trustees may also wish to review the approach to preparing agendas and meeting packs with their advisors with the view to making meetings more 'targeted' and 'focused'.

Finally, it is worth noting that, although the conclusion of the research is that there are some concerns with the quality of decision making, it is also acknowledged that "the pension trustees that participated in this research programme were clearly intelligent, conscientious, hardworking, committed to their responsibilities as trustees and altruistically motivated". The limitations of the research and the need for further studies is also acknowledged.

Helpful Links

IFOA - Pension Trustee Decision Making Report

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More savers caught in the lifetime allowance 'net'

Although the UK is beginning to emerge from our latest lockdown, government borrowing – the difference between public spending and income raised from taxes and other sources – will still reach a peacetime record in 2020/21. Before the Budget, forecasts anticipated that borrowing would reach between £350 billion and £400 billion. Also, even before new measures announced on 3 March, the Government's unprecedented financial support to public services, businesses and households came at a cost of around £280 billion. The sharp contraction in the economy in 2020 has meant significant falls in tax revenues.

It is within this context that the Chancellor delivered the Spring Budget 2021, unveiling a three-point plan to "protect jobs and strengthen public finances" –

1. Billions to support businesses and families through the pandemic
2. Investment-led recovery as UK emerges from lockdown
3. Future changes to strengthen public finances

Whilst the headline from the Budget was continuing support for those hardest hit (bringing total fiscal support to over £407 billion), key announcements from a pensions perspective were:

- Extension of the Coronavirus Job Retention Scheme (CJRS) for a further five months from May 2021 until the end of September 2021. Employees will continue to receive 80% of their current salary for hours not worked. There will be no employer contributions beyond National Insurance contributions (NICs) and pensions required in April, May and June. From July, the government will introduce an employer contribution towards the cost of unworked hours of 10% in July, 20% in August and 20% in September, as the economy reopens.
- This is relevant to trustees because the CJRS can impact the pensionable earnings upon which contributions and benefits are based.
- The government will maintain the Lifetime Allowance (LTA) at its current level of £1,073,100 until April 2026. In other words, more people could be impacted by the ceiling on tax relievable pension savings; especially those still lucky enough to have final salary pensions. Previous research suggests that the impact of the LTA has increased from circa 200 savers / £5m paid in tax to over 2,000 savers and £100m paid in tax between 2006 and 2018.

  The impact on revenue generated by the LTA change is shown in the table below.

EXCHEQUER IMPACT (£M)

2020 to 2021	2021 to 2022	2022 to 2023	2023 to 2024	2024 to 2025	2025 to 2026
-10	+80	+150	+215	+255	+300

No changes were announced to the Annual Allowance on pension 'inputs' nor, surprisingly, was there any mention of pension tax relief changes – not even for low earners in net pay schemes (although the outcome to a consultation on this issue is awaited).

- The national living wage will increase to £8.91 an hour from April. This can impact eligibility for automatic enrolment into workplace pensions.
- The rate of Corporation Tax will increase from 19% to 25% from 2023.

Also, the government is to consult on whether certain costs within the charge cap (currently set at a maximum of 75 basis points) affect pension schemes' ability to invest in a broader range of assets. This is to ensure pension schemes are not discouraged from such investments and are able to offer the highest possible returns for savers. DWP will also come forward with draft regulations to make it easier for schemes to take up such opportunities within the charge cap by smoothing certain performance fees over a multi-year period.

See "What's happening in DC", above.

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Climate change and pension schemes was not mentioned in the Budget but, on the same day, the Pensions Minister set out a timetable for regulations under the Pension Schemes Act 2021 which includes measures to ensure pensions are safer, better and 'greener'.

A useful 'what you need to know' factsheet on the budget has been published on GOV.UK, and full tax rates and thresholds for 2021/22 have now been published by HMRC.

The Finance Bill was published on 11 March.

From the perspective of pension scheme trustees, the Budget was, therefore, quite uneventful. They should, though, consider any impact of the extension of the CJRS on their pension schemes, might want to alert members to the freezing of the LTA (noting that some HMRC protections – Fixed and Individual Protection 2016 – are still available) and should look out for any changes affecting the charge cap and investments.

And a final thought. Will the increase to corporation tax influence the level or timing of employer contributions to company pension schemes?

Helpful Links

Written statements - Written questions, answers and statements - UK Parliament

Budget 2021 - What you need to know - GOV.uk

Rates and Thresholds for Employers - 2021 to 2022 - GOV.UK

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11 Coming up next...

Here are some of the events on the horizon that may be of interest to trustees and sponsoring employers.

- **TPR's Trustee Knowledge and Understanding ("TKU") Consultation** – in the first half of 2021 we expect to see the release of TPR's proposed updates to the Code of Practice on TKU and a request for feedback. A focus of the changes is likely to be how professional trustees are meeting the TKU standards and how this can be demonstrated through ongoing learning.
- **Increase to the Normal Minimum Pension Age ("NMPA")** – The Treasury announced a consultation in regard to its proposals to increase the NMPA from 55 to 57 on 6 April 2028, alongside the proposal for a protected pension age regime. Towards the end of 2020 the government announced its intention to increase the NMPA as a reaction to the changes across society of increased longevity and working lifetimes of individuals. The proposals include protection for members of schemes who (as at 11 February 2021) have a right to take their pension at an age below 57, which includes any benefits yet to be accrued. The consultation is open to submissions until 22 April 2021, with the government expected to publish draft legislation in the summer.
- **Pension Scams** – We said in our last update that we expected 2021 to bring a much welcomed, and much needed, tougher stance on preventing scams. The first quarter of 2021 hasn't disappointed, with the revised Pension Scams Code of Practice from the Pension Scams Industry Group being launched just before Easter and an assortment of recommendations coming from the Work and Pensions Committee, following its inquiry into the impact of pension freedoms and scams. On the latter, of particular note were recommendations for Project Bloom to have a statutory footing, HMRC to review the imposition of tax charges on scam victims and social media/ tech firms to do more to tackle scam adverts on their platforms. There seems to be a real tail-wind behind this issue, so we hope to see real progress in the coming months to implement these much-needed reforms.

Trustees and sponsoring employers alike should also be aware of the following key dates in the coming months:

- **29 April 2021** – Closing date for the DWP's consultation on changes to the contribution notice regime and TPR's information gathering powers, again, as discussed in our article on the Pension Schemes Act 2021.
- **4 May 2021** – Appeal of the decision of the High Court in Hughes v The Board of the PPF (PPF compensation case), to be heard at the Court of Appeal.
- **13 May 2021** – Appeal of the decision of the high Court in Britvic Plc v Britvic Pensions Limited (a case dealing with pension increase and revaluation provisions) to be heard at the Court of Appeal.
- **26 May 2021** – Consultation period closes in relation to TPR's draft single code of practice relating to governance of schemes (to replace ten of the existing codes), as published in March 2021.
- **9 June 2021** – action may be needed for schemes that have been using fiduciary management services. If an existing fiduciary management agreement dates from 9 June 2016 or earlier the trustees have until 9 June 2021 to complete the retender exercise and appoint (or re-appoint) a provider
- **30 September 2021** – The Coronavirus Job Retention Scheme is due to end, subject to any further extension by the Chancellor.

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Dalriada. A better way

Belfast

Linen Loft
27-37 Adelaide Street
Belfast
BT2 8FE

Birmingham

Edmund House
12-22 Newhall Street
Birmingham
B3 3AS

Bristol

Castlemead
Lower Castle Street
Bristol
BS1 3AG

Glasgow

The Culzean Building
36 Renfield Street
Glasgow
G2 1LU

Leeds

Princes Exchange
Princes Square
Leeds
LS1 4HY

London

46 New Broad Street
London
EC2M 1JH

Manchester

82 King Street
Manchester
M2 4WQ

Dalriada Trustees Limited is a company registered in Northern Ireland with registered number NI 38344 whose registered office is at Linen Loft, 27-37 Adelaide Street, Belfast, BT2 8FE. VAT number 974 8252 79.