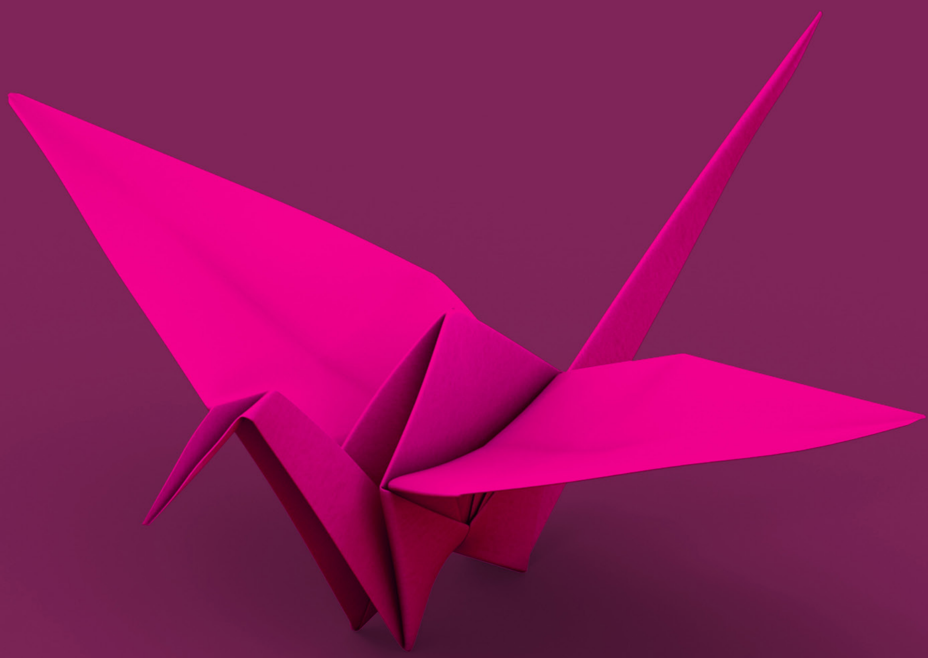
Your Quarterly Pensions Update

Dalriada Trustees – Industry Changes

Quarter Two 2023



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Contents

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.

1 STOP PRESS! Mansion House Speech rundown

The Chancellor, Jeremy Hunt, outlined plans in his Mansion House speech on 10 July 2023 to encourage pension schemes to invest up to £75 billion in the economy, as part of broader regulatory reforms for the UK's capital markets. The plans are subject to calls for evidence and consultations, but decisions are still expected by the Autumn statement in November.

Key points to note include the following (we will explore these issues in more depth in Quarterly Update 3/2023):

- **Trustee skills, capability and culture.** The Government has published a new call for evidence to support the development of policy options for improving the skills and capability of pension scheme trustees (of all types of scheme – DB, DC and hybrid) and to remove barriers to trustees' ability to make effective investment decisions. In particular, views are sought on whether trustees have the right knowledge and skills to consider investment in the full breadth of investment opportunities.
- **DB superfunds.** In its response to a 2018 consultation on the legislative framework for the regulation of defined benefit (DB) 'consolidators' or 'superfunds', the government states that it wants to see this market develop. Consequently, DB employers and trustees could have an alternative to pension scheme buy-out and superfunds could use their scale to invest in assets that support the UK economy. Primary legislation will be needed first and so it is still likely to be a while before we see the first transactions taking place.
- **DB innovation.** A new call for evidence has been published which could lead to more choices for DB schemes as well as supporting wider economic initiatives. The call for evidence covers the current rules around surplus refunds; more consolidation options (including the prospect of a public sector consolidator, potentially run by the Pension Protection Fund); and the role of DB schemes in "productive finance". The call for evidence emphasises that decisions on asset allocation will continue to be a matter for schemes themselves.
- **Collective Defined Contribution (CDC)**. In a response to its consultation on extending CDC provision beyond single/connected employer schemes in order to accommodate unconnected multi-employer schemes, the government confirms that it will consult on draft regulations to fulfil this objective. There is also a commitment in respect of provision for CDC decumulation products. The government believes that, through CDC, schemes could invest more effectively by pooling assets.
- **Value for money.** In a response to an earlier consultation on a new value for money (VFM) assessment framework for defined contribution (DC) schemes, the government signals a shift of focus from costs to value through the consideration of factors, such as investment performance, essential to longer term saver outcomes. The VFM framework also aims to accelerate further consolidation in the DC market by, inter alia, providing the Pensions Regulator with powers to require wind ups and consolidation where schemes are not delivering VFM to their members. Again, the changes will require primary legislation and the intention is to introduce them in phases.
- **Helping DC savers with pension choices.** The Government has published a response to its call for evidence on helping savers understand their pension choices and a new consultation on a decumulation framework to support individuals when they access their pension savings (i.e. at the point of decumulation). Trustees of DC schemes will prospectively have a new duty to offer decumulation services to their members. This does not mean that schemes will have to offer all decumulation choices directly; they can instead partner with another supplier. Members will have the choice of the default service offered by their scheme or accessing options available under pension freedoms.
- **Deferred small pension pots.**: Alongside a response to its call for evidence on addressing the challenge of small pots, the government has issued a consultation on its proposed automated consolidation solution. The preferred option is a multiple default consolidator model, under which deferred small pots, meeting the eligibility criteria for automatic consolidation, will transfer automatically to one of a number of consolidators. Members will have an opportunity to opt-out as well as the option to choose their consolidator. An enhanced authorisation regime for schemes to act as a default consolidator is also proposed. Whilst these changes could help solve the problem of small pots, they will also necessitate the introduction of new processes for pension schemes.

2 Single code published – we wish!

Oh Single Code, where art thou?

It seems extraordinary that the Single Code of Practice on Pension Schemes (now to be known as the General Code), despite being consulted on in March 2021, has still not been officially published, let alone brought into force.

Our current understanding is that a final draft has been produced by the Pensions Regulator and that this has been passed to the Pensions Minister, Laura Trott.

Nevertheless, the Code has yet to be laid before Parliament and, given that it must be laid for 40-days under the negative affirmation process, it cannot complete before the Summer recess, meaning that it will not see the light of day before the Autumn (for the House of Commons, the House rises on 20 July 2023 and returns on 4 Sept 2023).

It is further understood that, for the purpose of Own Risk Assessments (ORAs), once published, the Code will not take effect until April 2024. In addition, recent comments from a regulatory representative have indicated that the timing of the ORA will be 'more aligned' to the statutory instrument (SI 2018/1103), rather than the draft code.

Whilst the expectation was for the Code to be in force long before now, it is important to emphasise that the regulations underpinning the Code and requiring schemes to have 'an effective system of governance (ESoG) including internal controls' have been legally in effect since 13 January 2019 (yes, you read that correctly)!

So, given this 'mis-match' between the law and the detailed requirements expected to set out in the Code, what should trustees be doing now?

Our view is that Trustees are the stewards of the members' future financial wellbeing and it really doesn't get any more important than that. A Trustee's focus must therefore be to ensure that the right benefits are provided to the right members at the right time and having a system of governance in place that not only supports doing that but also evidences that it is effective. To want to operate an ESoG is a behaviour and doesn't require a code. However, to assist, the Regulator's draft code is available and recent comments from a regulatory representative indicated that the final version only has some small changes to the Risk Management Function, the Remuneration Agreement, the timing and content of the ORA.

To begin to document their ESoG, trustees should:

- Establish the Risk-Management team responsible for compliance with the ESoG requirements
- Read SI 2018/1103, the draft code and deliver training for the Risk-Management team
- Draft and agree policies for the Risk Management, Internal Evaluation and Actuarial Functions, together with the Outsourcing policy, as all four need the prior approval of the Trustees before undertaking the activities
- Complete a governance framework assessment, including documenting the proportionality applied to the Scheme's activities and the contingency plans (Gap analysis phase 1)
- Complete a review of all of the Trustees' documents, policies, processes, procedures, logs, registers, statements and lists, and using the draft code as a guide, evaluate what is needed for the Scheme (Gap analysis phase 2)
- List all possible improvements in order of priority
- Incorporate the agreed governance improvements in the Scheme's Business Plan, set the completion dates and make the improvements
- Await publication of General Code / final details of the ORA, the requirements of which will be much easier with all of the above steps completed (but don't hold your breath on the timing!)

Helpful Links

Single code of practice consultation | The Pensions Regulator

The Occupational Pension Schemes (Governance) (Amendment) Regulations 2018 (legislation.gov.uk)

3 Pensions Dashboards Update

The Society of Pensions Professionals recently ran a poll of their members regarding plans for Dashboards readiness.

This was off the back of the DWP announcement of a delay to the program with an endpoint no later than October 2026.

The headline was that of 93 consultants surveyed 73% reported a significant slowdown in activity.

Whilst the industry response to the delay wasn't totally unexpected the sound of cans being kicked further down the road is not encouraging.

The delay to the program whilst understandable, given the lack of readiness of certain parts of the industry, needs to be treated as an opportunity to get things ready. Not just to defer taking action

All change no change

Whilst there is now a lack of certainty over staging dates for schemes, the risk is that downing tools now means that there could be a capacity crunch towards the launch of the program.

From first hand experience it's clear that some schemes are just pushing things mentally out of view.

In conversation with the Pensions Manger of a scheme with some 30,000 members in scope for Dashboards, I probed what percentage of ERI calculations could be fully automated. Around 80% was the answer.

So that's potentially 6,000 manual ERI calculations that need to be performed within the 13 day SLA. I asked if that was possible. Probably not was the answer given, as the admin team were already pretty much flat out already.

It gets worse. The calculations above assume that data is good enough to run all the automated ERI calculations. I asked if that was the case? Probably not was the answer.

Take action

Dashboards aren't going away. The Draft Pensions (Amendment) Regulations 2023 were laid before Parliament on the 3rd July.

Laura Trott the Pensions Minister reiterated that schemes would need to comply with the regulations.

Against this backdrop its vital that schemes assess their readiness and ask the hard questions of their administrators.

- Have they completed a readiness assessment for your scheme?
- Is all the required find data available digitally?
- Is the data quality sufficient to enable an ERI to be calculated?
- What percentage of ERIs can be calculated automatically, subject to good data?
- How many manual ERI calculations are anticipated for your scheme and how will they be resourced?
- How will they connect to The Dashboards infrastructure?

The hard questions now may save a lot of pain later in the process!

4 Annual funding statement

Key messages from TPR's Annual Funding Statement 2023

The 2023 annual funding statement provides guidance for valuations with effective dates between 22 September 2022 and 21 September 2023 (Tranche 18 schemes).

There are a number of key messages from the Pensions Regulator (TPR):

- Most schemes have improved funding levels through a combination of investment out-performance from return-seeking assets and a significant rise in gilt yields. Trustees will need to consider if their long-term targets remain appropriate.
- If funding levels have improved significantly, trustees should consider whether continuing with the existing strategy and level of risk is in the best financial interests of their members and beneficiaries.
- Funding levels will have fallen for a small number of schemes, Trustees should reset funding and investment strategies to reach their long-term targets and should review their operational governance processes to ensure future resilience. Trustees, their investment managers and advisers should read TPR's LDI guidance for more information.
- The level of risk that trustees decide to build into their scheme's funding and investment strategies should be supported by the employer covenant. It is important to avoid complacency when monitoring the employer covenant, ensuring effective information sharing protocols are adhered to, and assessing the impact of any changes.

TPR splits schemes into three groups:

Group 1 Funding at Buyout or above	Group 2 Funding between Buyout and Technical Provisions	Group 3 Funding below Technical Provisions
•Consider whether to secure terms with an insurer or run the scheme on? consider risk/reward strategies of all options for members and employer. •Note capcity of insurer market and likely increased timescales.	•Ensure the long-term funding target remains appropriate given funding position and covenant. •If Trustees don't have a long term funding target in place one should be agreed as a matter of priority.	•Focus on bridging the gap to Technical Provisions. •Ensure the funding plan is consistent with the covenant. •If the funding position has improved, understand how this fits in with long term plan and any action that should be taken.

Other points to note:

- Investment Strategy. TPR note a number of points around illiquid assets – Trustees should take advice to make sure these assets are still appropriate. Trustees should also consider ability to meet LDI collateral calls.
- Covenant. On average, covenant is likely to improve due to reductions in scheme size. However there are a number of negative impacts on covenant including low economic growth, high borrowing costs and high energy costs. Trustees should ensure they understand the covenant, and the period of covenant reliability.
- Mortality. TPR noted that mortality has begun to stabilise following the Covid 19 pandemic. However Trustees should still approach assumption setting with care.
- Schemes with active members. TPR notes that the cost of providing benefits will have fallen significantly and these schemes may see more material changes in funding level due to their long-time horizons.

Overall, Trustees managing schemes in an integrated way - i.e. looking holistically at funding, investment and covenant - will be well placed to ensure valuations meet TPR expectations. TPRs helpful classification of schemes into bands also helps with understanding TPR expectations for specific schemes.

One eye should also be kept on the new DB funding code, which is currently expected to take effect in April 2024.

Helpful Links

Annual Funding Statement 2023 | The Pensions Regulator

5 Pensions Regulator ED&I guidance

Equality Diversity & Inclusion

The launch in March of TPR's guidance on Equality, Diversity & Inclusion (EDI) was a milestone for pensions. Although for many years well-run schemes have been incorporating EDI into their structure and decision making, the guidance from TPR supplied clear direction for all trustee boards, and their corporate sponsors.

The guidance from TPR is principles driven and pragmatic, recognising that while EDI issues can be complex, there are "quick and easy steps that some schemes can and should take to improve EDI now".

One thing TPR suggest is that EDI outcomes can be improved by widening the pool of people from which trustees are generally drawn. Also, acknowledging that any new trustees may require tailored training and development to fully engage in challenge and debate.

Similarly, the organisation and structure of meetings can be reviewed to be made inclusive for all, to encourage full participation from every member of the board. Where there is a risk of "groupthink" emerging, mechanisms that encourage divergent and individual thinking will help better decisions to be made. This could lead to better policy design, better investment choices, and a reduction in the risks faced by the pension scheme.

When running an MNT selection exercise or designing member communications, trustees can ensure EDI is considered a core part of the process to help their scheme maximise their EDI potential.

Where employers are making changes to their pension arrangements or setting up new schemes, it is important to consider the wider impact of these changes on the members. There is a well-researched gender pensions gap in the value of funds at retirement and similar gaps will exist when looking at different socio-economic groups. Scheme design changes that look to address this (for example when considering how maternity leave is accounted for within pension schemes and dealing with members wishing to work part-time) will be beneficial in terms of supporting the narrowing of these gaps and promoting economic stability.

There is an enormous array of ways that pension schemes can improve their EDI impact, and the TPR guidance sets these out in a very accessible level of detail. Following these principles and challenging the status-quo will lead to better decisions being made and an improvement in the impact that individual pension schemes can make to their members, trustees and corporate sponsors.

Helpful Links
Governing body guidance | The Pensions Regulator

6 Pensions Regulator update on Capita Security breach

Capita cyber security incident

Capita are a company that provides, amongst other services, third party pension scheme administration. In March 2023, Capita experienced a cyber security incident. As a result of this incident, criminals were able to access personal member data of pension scheme members.

This impacted not only current Capita clients but also pension schemes who used Capita for administration services in the preceding three years. It has also emerged that some Capita staff may have been impacted as their own scheme was affected by the cyber breach.

Schemes that have been impacted will have notified both the Information Commissioner's Office (ICO) and the Pensions Regulator (tPR) as well as writing to all affected members and taking steps to secure their systems and data.

As well as causing distress to impacted pension scheme members, this incident also resulted in disruption at Capita in the provision of ongoing pension administration services as it sought to identify exactly what data had been compromised and restore access to their staff to IT systems. This will have impacted Capita's ability to service its clients. Capita has also said it expects to incur costs of between £15m and £20m as a result of the cyber incident which occurred in March.

This incident has reminded everyone associated with running a pension scheme how precious member data is and the risk of cyber attacks. Pension schemes hold large amounts of personal data and assets, which can make them a target for fraudsters and criminals. Although the Capita cyber breach has been well publicised , there will be criminals targeting pension member data whoever holds it. Not long after people were made aware of the Capita cyber security breach another breach was in the headlines relating to a payroll provider Zellis which impacted the staff of a number of household names.

Therefore, this incident shows the importance of having a robust cyber security and business continuity plan in place.

What to do next?

There are many lessons to be learnt from the cyber breach for trustees as well as administrators and other third parties that hold member data. This incident was caused by unauthorised access to Capita's servers. Hackers try and access data in many ways including sending phishing emails with links as well as more direct attempts to hack servers. All trustees should take steps to build their cyber resilience – their ability to assess and minimise the risk of a cyber incident occurring, but also to recover when an incident takes place.

Trustees need to work with all relevant parties (including in-house functions, third party service providers and employers) to define their approach to managing this risk and the action plan should a cyber incident impact their scheme.

Trustees should review their cyber security protocols in particular:

- Ask your providers (whether in house or external) to confirm what cyber security controls are in place to minimise the risk of a breach covering systems, processes and people. You may want to ask about what test are carried out such as penetration testing and what staff training takes place, its frequency and follow up actions should staff click on links in phishing email testing. There are also a number of accreditations that organisations can obtain which help you or your suppliers demonstrate cyber readiness.
- As trustees think about steps you can take to minimise the transfer of personal data and ensure that all data is transferred in the most secure ways.
- Refresh your incident response plan to cyber security incidents making sure that you have details of all the key people involved should a breach occur. Consider delegating the response to a sub-committee of the trustee board noting the short timescales required to inform the ICO (within 72 hours of being made aware of an incident).
- Monitor and test your controls and make sure your suppliers are doing the same and reporting back to you.

- Make sure you consider cyber security on a regular basis as this is an ever evolving area. Criminals will be continuously developing ways to get at member data so the pension industry needs to similarly continue to develop so that we can maintain the security around member data.

Although the Capita incident was sophisticated, there are many other ways criminals may try and access personal data so be vigilant. It is also fair to say that although this incident impacted Capita and their current and historic clients, this could have impacted any third party supplier and now is definitely not the time to be complaisant.

So be careful, review your cyber security resilience, consider what steps you can take to improve it and monitor it regularly.

Helpful Links

Capita cyber security incident | The Pensions Regulator

Cyber security principles The Pensions Regulator | The Pensions Regulator

7 Like a Virgin (Media v NTL Pension Trustees)

After a number of false starts, the 'section 37 question' finally went all the way to court. Judgment in the case was delivered on 16th June, leaving the industry waking up to the issue and, frankly, feeling scared and cold.

The case was about these vexed questions:

- Whether the lack of written confirmation by the Scheme Actuary that the scheme continued to match the reference scheme (the mythical scheme which you had to match to contract-out of SERPS/S2P) could scupper an amendment to the rules of a contracted-out scheme;
- If so, could it scupper amendments in relation to future service as well as past service; and
- If so, could it even scupper amendments which improved benefits?

In a judgment even less popular with the industry than Lloyds[1] (1, 2 and 3 - I think we're all hoping for better sequels this time), the court said 1. Yes; 2. Yes; 3. Yes!

Didn't know how lost I was

The Judgment is pretty short (at least in comparison to some pensions Judgments) but that masks a great deal of complexity. And that's because, as is common with pensions legislation, the legislation under consideration[2] is written in a very convoluted fashion (with a sort of three way effect of prohibition, permission and then prohibition again, along with definitions mixed in). And, ultimately, that legislation simply didn't make any real policy sense.

Virgin's Counsel offered the court a plethora of credible reasons to avoid a result quite so hard to swallow; in particular, by making the legislation all about the past (given it uses the words "accrued rights") which would have made it virtually irrelevant. However, instead, the court tried to make the legislation they were looking at[2] mean the same as the shiny and new legislation that was made in 2013 to "clarify" matters. In fairness, the court hadn't the hands on experience to appreciate that pensions legislation (understandably, given the complexity) sometimes just doesn't say what it should do (indeed, DWP had all but admitted as much in 2013).

The result is that those who used their hands on experience to judge what was a sensible interpretation of the muddled legislation and/or didn't give enough credence to how the words might be read, will now potentially find themselves with a problem child. The kind that seriously adds to your liabilities and causes you untold hassle in establishing what went on 20 odd years ago.

Making it Through the Wilderness

I don't think there is much doubt that there will be a significant number of benefit amendments that, on the basis of this case, will be void. Depending on who you ask, this could include the most fashionable amendment this millennium - closure to accrual[3]. Plainly, it could include benefit improvements (though that will be rare in this period) and it could also include schemes which have wound up, or are in the PPF or FAS.

If there is an appeal (and a hearing on this and other issues will take place during July), Virgin could fare better - as there are judges in the Court of Appeal whose practice included pensions and who may be more familiar with the established meaning of pensions-speak.

There's also a question of what exactly is needed to evidence the confirmation required. It seems clear that will fall short of a certificate but exactly what will be needed is still to be seen.

My own view is that, ultimately, DWP may need to come to the rescue and make some regulations to allow retrospective validation of amendments which did not offend the principle the legislation ought to have been aimed at (which, as I see it, was stopping schemes which did not match the reference scheme continuing to contract-out). Otherwise, there may be many schemes touched by a long awaited and dreaded judgment - admittedly perhaps not for the very first time

[1] on GMP equalisation

[2] For the period from 6 April 1997 until 5 April 2013

[3] Albeit this feels very odd, since the contracting-out certificate would have been surrendered at this point.

8 Transfer Value regulations

Are the Transfer Value Regulations working?

The government had committed to publish a review of the Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021 (the regulations that introduced the red, amber and green flags systems for members interested in taking a transfer) within 18 months of the regulations coming into force (i.e. by the end of May 2023). The object of the review was to determine whether the regulations remain appropriate / effective in targeting pension scams and whether they give rise to unintended consequences.

After a small delay, the results of this review have been published, with the DWP concluding that it will conduct further work with the pensions industry and the Pensions Regulator to consider if changes could be implemented to the regulations to improve the pension transfer experience but without undermining the policy intent.

To given some context to the conclusion, based on the data gathered (from over pension schemes, administrators and industry bodies), the government estimated that, from 290,000 transfers, only 1% (i.e. 2,900 transfers) had a red or amber flag present (i.e. flags which could have prevented or at least delayed a transfer). Moreover, 2,400 of those were amber flags. This leads the government to believe that:

- the low percentage of transfers with a red or amber flag (1%) indicates there has not been a disproportionate cost to business following the implementation of the regulations,
- while data suggests that the regulations have not significantly lengthened transfer times, the increase in waiting times for a Money and Pensions Service (MaPS) pension safeguarding appointment may have potential costs, and
- the original policy intent of the regulations remains appropriate.

The DWP did however hear evidence that the incentives flag is incorrectly blocking transfers due to the different interpretation of this flag by some providers. In addition, the review suggested that the overseas investment amber flag needs to be more clearly defined or removed. It was argued that the way this particular flag is structured can mean that an amber flag needs to be raised even when schemes have no concerns. The review found that overseas investments including in the receiving scheme was the most common amber flag at 57% of amber flags recorded.

It is disappointing that no specific proposals have been made to address issues such as overseas investments (where delays in transfers can occur simply because a member's transfer will be invested in a pooled fund which may include such assets) and incentives (where otherwise legitimate marketing strategies can prevent a member from transferring).

That said, given the pensions industry's concerns on the application of the regulations (particularly, the incentives and overseas investment flags), the DWP will conduct further work to consider if changes could be implemented to improve the pension transfer experience but without undermining the policy intent. Any changes are though unlikely to take effect before next year.

It is also encouraging that whilst some pension scheme members have potentially had issues in so far as transfer requests being delayed or blocked, it is reported that, to date, the Pensions Ombudsman has received only a small number of complaints. Further, most of these are in respect of blocked transfers where there has been a red flag.

Dalriada's Irregular Schemes Team experiences on a daily basis the impact faced by members who have transferred their pension arrangement(s) into what they often later learn is a pensions scam. Any inconvenience caused in a small percentage of cases needs weighed up against minimising the risk of members potentially losing their entire pension funds (often their second biggest asset).

In many cases members can also be 'sucked in' by those attempting to defraud them, who are often persuaded that it is a fault of their ceding arrangements to unjustifiably attempt to hold on to their pension benefits. Clear-cut guidance is essential in enabling transferring arrangements to properly exercise their responsibilities when faced with a transfer request, as well as avoid future claims against their due diligence conduct.

Tactics by scammers will also constantly adapt therefore regular reviews of the guidance to ensure that it adapts to any changing tactics may be prudent.

Helpful Links
Conditions for Transfers Regulations 2021: Review report - GOV.UK (www.gov.uk)

9 Investment update

Market Review

The second quarter of 2023 bought into focus the idea that the journey to economic recovery may be a long and windy road!

Given the backdrop of 2022 and early 2023 investors entered the quarter with the expectation of a looming recession and the potential for rate rises to level off. In actual fact inflation remained stubbornly high, despite prior rhetoric of its short term presence many central banks continued with the policy of increasing short term borrowing rates. Against this backdrop both shares (with the exception of the US and Japan) and bonds delivered disappointing returns as investors priced in further interest rate rises and an increased risk of recession.

Global markets

Global equities edged higher over the quarter, driven by the US and Japan, with a noticeable rebound in mega-cap stocks (which underperformed in 2022), whilst emerging market regions continued the trend of lagging behind. The UK and Asia Pac region (excl Japan) delivered negative returns over the period.

Credit and government bonds are yet to recover from the "crisis" in 2023, with longer dated UK government bonds particularly impacted falling a further 6% in value over the quarter. Those few asset classes that delivered positive returns last year, such as commodities (driven by energy price increases) have struggled year to date. This inflection in performance shows the importance of reviewing portfolios on a regular basis and ensuring portfolios remain diversified.

Many central banks continued the movement of raising interest rates to combat inflationary pressures although the Fed bucked the trend and held rates in June. In almost all regions government bonds yields rose and prices fell.

UK

UK equities fell over the quarter following heightened recessionary risks and continued hawkish comments emanating from the Bank of England (BoE). The Bank continued its strategy of rate rises during May and June. The most recent surprise 0.5% increase was viewed by some commentators as an attempt to shock the economy to combat continued and stubborn inflation. The action of the Bank suggested controlling inflation in a steady measured way remains somewhat aspirational, which resulted in UK gilt yields rising further (falling prices) to levels last seen during the during the "gilts crisis" in late 2022.

By the end of the quarter, gilt yields had again fallen slightly suggesting investors viewed the action taken by the Bank as potentially being successful in taming inflationary pressures, albeit with the impact of potentially forcing the economy into a recession.

Following the market volatility in autumn 2022, the Pensions Regulator (TPR) has published new guidance on the practical steps trustees should take to manage risks when using leveraged liability-driven investments (LDI). The guidance sets out that TPR expects trustees to invest only in leveraged LDI arrangements where there is an appropriately set of conditions including:

- Being very clear where LDI fits within a scheme's investment strategy both longer term goals as well as shorter term issues such as liquidity
- Setting, operating and maintaining a collateral buffer including ongoing testing for resilience
- Making sure schemes have the right governance and operational processes in place
- Ongoing monitoring of all the above

Whilst many schemes will have been considering these points the compliance across the industry will not have been uniform partly because of the structure of the Trustee function, it's legacy attitude and the input of it's adviser. We will be putting in place additional controls to make sure that an appropriate level of governance is included in annual business plans and in budgets and that the work is then undertaken. As always we are comfortable to engage with the Sponsor on these matters.

Also, the Work and Pensions Committee (WPC) has published a report on DB pension schemes with LDI investments. According to the WPC more still needs to be done to address significant weaknesses in the ability of defined benefit pension schemes to manage risk. The report warns that investments must never again be allowed to jeopardise the stability of the UK economy as they did during the events of September last year.

US

The US market performed strongly in local currency terms, up 9%. These gains were almost entirely due to a rebound in mega-cap stocks which make up a very large proportion of the US market.

The dollar weakened against sterling during the quarter, as a consequence of higher base rates implemented by the BoE. As a result investors hedging US exposure back to sterling would have received 6% in sterling terms.

US inflation fell, due to the observed 2022 oil price increases falling away, allowing the Fed to pause any rate increases in June.

Euro

Eurozone shares posted positive returns, returning 3% over the period.

Like the BoE, in order to combat higher inflation, the European Central Bank (ECB) raised interest rates twice over the quarter, despite this inflation crept up over the period, increasing the probability of a recession in the region.

Japan

Japan was the best performing equity market over the quarter in local currency terms. The region benefitting from a weak yen, as a result of relatively low interest rates in Japan compared to other countries where rates have risen.

The Bank of Japan (BoJ) met for the first time under their new governor which led to little policy change suggesting the Banks dovish position appears set to continue.

Asia (ex Japan)

Asia (ex Japan) equities recorded negative returns during the second quarter. Weak demand for exports following interest rate rises in the US and Europe dampened returns. Within regions technology stocks (linked to AI-related firms) drove returns.

Emerging markets

EM equities generally lagged developed markets, although delivered a marginally positive return over the period. Concerns over China's reopening held back the region in general.

Fixed Income

Within fixed income, credit assets delivered muted returns, failing to recover lost ground in 2022, with investors facing up to the fact that rates aren't likely to come down any time soon. Higher yields continued with elevated inflation data, hawkish central banks and rising interest rates.

Assets at the riskier end of the spectrum, high yield and emerging market debt drove returns, whilst defensive classes retracted. UK Gilts in particular suffered with inflationary concerns and BoE actions taken to address this, likely to mean rates are likely to stay higher for longer.

Summary

The volatility and dispersion of asset class returns demonstrates the importance of diversification in portfolio construction. Increased base rates, brings cash back to the table as a strategic allocation, pending investment in undervalued asset classes, but doing so without the historic impact of return dilution.

Enhanced yields also means fixed-income investments are potentially more attractive than they have been for a number of years.

For schemes which have had underhedged positions, elevated gilt yields and the outlook for rates to remain higher for longer presents an opportunity to lock in potential reduced deficits.

The outlook suggests things remain rocky and the journey ahead may have a number of turns to take.

Helpful Links

Defined benefit pensions with Liability Driven Investments - Committees - UK Parliament

10 DC Update

Supporting DC savers

The Pensions Regulator (TPR) has published a guidance statement setting out how trustees of defined contribution (DC) schemes should communicate and support savers in the current challenging economic climate and how they can strengthen the governance and oversight of DC schemes and ensure their investment strategies support stronger saver outcomes.

The guidance statement takes many of its key themes from TPR's DC code of practice and associated guides on investment governance and communicating and reporting. It also builds on TPR's earlier statement on managing investment and liquidity risk in the current economic climate, which focused on the issues TPR expects trustees to consider when managing investment and liquidity risks in the face of current market conditions.

Although DC schemes do not involve leverage in their investment strategies and have not been affected by the issues facing liability-driven investment (LDI) funds, DC savers are not immune to market events. Significant market volatility from both equities and falling bond values, along with increases in inflation and interest rates, has affected those accessing their pension savings.

In the guidance statement, TPR says that, while those who are early in their saving journey can take a longer-term view on their investments, savers who are close to retirement could be impacted depending on the investment strategy of their scheme.

Savers in 'lifestyle' funds need to understand whether the strategy they are in, as they approach retirement, is consistent with their plans on how they intend to access their retirement benefits.

Trustees should also communicate with savers to help them understand what a fall in their DC pension means for them, depending on their personal circumstances, and to avoid making hasty decisions that could lead to risks such as being victims to pension scams.

In particular, trustees can direct people to the Money and Pensions Service's MoneyHelper service, which offers free, independent help and guidance for people of all ages and includes free guides, a pension calculator and free appointments for those over 50 with an expert via Pension Wise. MoneyHelper can also help people find a regulated financial adviser, if they need one, to make a final decision. From 1 June 2022, schemes have been subject to requirements to 'nudge' members to Pension Wise when they are accessing or transferring to access flexible (DC) benefits. In addition, just before going to print, the Pensions and Lifetime Savings Association (PLSA) has published 'Supporting savers through the cost of living crisis'; a resource for pension schemes, which is intended to provide guidance to schemes that wish to share additional information with savers struggling due to the increased cost of living; including pension credit, cost of living payments, help with energy costs and childcare, and income support.

On a related note, the DWP has just launched a new 'Midlife MOT Website' to aid older workers with financial planning, including understanding their money, pension and any debt; to help workers with health guidance; and to evaluate what their skills mean for their careers and futures.

TPR has also reminded trustees about the importance of annual benefit statements (and accompanying information and guidance) as part of member communication, suggesting that trustees consider follow-up targeted communications as part of a continuous process. The regulator states that "Trustees should consider what information and guidance goes alongside those statements to help savers, but within the format requirements for simpler annual benefit statements, where these apply."

While acknowledging there is no one-size-fits-all answer, TPR expects all trustees to consider the issues raised in the guidance statement and take appropriate action as part of their ongoing governance responsibilities.

There is a handy checklist for trustees to develop an action plan (see the links, below).

Separately, TPR has published the results of a survey, stating that too many defined contribution (DC) schemes, especially smaller ones, are failing to meet expectations on assessing value. The survey results showed that only around one-quarter (24%) of DC schemes met TPR's key governance requirement and that there is a lack of awareness from small schemes around the Value for Money (VfM) assessments, with smaller schemes also less likely to take action on financial risks caused by climate change than larger ones.

Also, while we eagerly wait for the outcome of the consultation on the new Value for Money (VfM) framework and the metrics to measure VfM, the general 'new' direction of travel for engaging members is the promise of a tide of digital connectivity, which seems, initially at least, to be based around delivering what has been discussed for a number of years; connecting digital Banking and Pensions to enable Open Finance to provide members with a more holistic view of their overall finances. However, the development of the Dashboard, which is now intended be live from October 2026, seems to be accelerating this progress and which, together with the development of AI, has the potential to revolutionise how pensions are administered and communicated, in order to create good member outcomes.

Finally, ahead of the Chancellor's Mansion House speech, some of Britain's biggest DC pension providers have agreed a voluntary pact, estimated to be covering two-thirds of the DC pensions market, to commit 5% of their investments to private equity and early-stage businesses. This will potentially invest up to £50bn by 2030. The Chancellor's speech is expected to develop his "budget for growth" and the promised package of measures by the autumn, setting out a series of reforms intended to channel tens of billions of pounds of Britain's pensions savings into high-growth companies.

Helpful Links

Supporting defined contribution savers in the current economic climate | The Pensions Regulator

DC code of practice | The Pensions Regulator

Investment DC pension schemes | The Pensions Regulator

Communicating reporting DC pension schemes | The Pensions Regulator

Statutory guidance: Simpler annual pension benefit statements - GOV.UK (www.gov.uk)

Check the status of your work, health and money - Midlife MOT (jobhelp.campaign.gov.uk)

11 Coming Up Next

Half of 2023 is gone… how did that happen!? Perhaps this writer is just getting old, but the pace of the passage of time is truly terrifying. Which, I suppose, is the whole rationale behind this Quarterly Update and, in particular, this ever-present piece where we look at what is Coming Up Next in the pensions calendar.

When drafting this traditional end to our report, one can sometimes question including some of the key dates and events as they simply feel too far away. "Winter 2023, April 2024, Summer 2024… sure they are ages away! We have an actuarial valuation to sign off this week, our investment manager selection is in two weeks and there is a trustee meeting at the end of the month… I don't have time to worry about Summer 2024!" All perfectly natural reactions but, with how time passes, it is amazing how quickly Summer 2024 can be upon us.

So, as ever, we end the Quarterly Report by offering up a brief summary of those future events – both near and far – that we think you should be preparing for. We urge you to take a beat, move your focus (temporarily) from the urgent, should-have-been-done-yesterday tasks on your to-do list, and ponder what needs to be put in place to deal with tomorrow's onrushing issues.

TPR General Code of Practice

- Patience is a virtue. A favourite line of my mother's, which is certainly a line that is being tested by the wait for the General Code, first consulted on in 2021.
- While Spring didn't bring the publication, DWP have said it will be this year and it surely cannot be far off.
- If trustees hadn't started preparing for the General Code (previously the Single Code), now is definitely the time to review the requirements and get an ESOG in place. They should also be preparing for their first own-risk assessment (ORA), as this will need to be completed within a year of the General Code coming into force.
- Who knows, by the time this Quarterly Report has been published, the General Code may be before Parliament and be coming into force within 40 days. Good things come to those who wait. Another favourite of my mother's!

Online Safety Bill

- This Bill is focused on establishing a regulatory framework for certain online service providers, creating new offences relating to online harms, including offences of false communications. While certainly not focussed on pension scams, the provisions of the Bill will be useful in tackling pension scams before members become victims.
- The Bill will require search engines, websites and social media platforms to tackle illegal activity, with a legally enforceable duty to remove suspected scammers and scam adverts immediately on notification. These online providers will need to improve their due diligence processes, to make it more difficult for scammers to advertise and propagate pension frauds online and via paid adverts.
- While there may not be direct requirements on pension scheme trustees or employers from the Bill, it should serve as a reminder for schemes when communicating with members, to flag the dangers of pension scams, and in particular via social media adverts.

Building on those selected topics, here are some key dates to keep in your diary as we tear through 2023:

- **Summer 2023** – Economic Crime and Corporate Transparency Bill expected to receive Royal Assent, bringing in requirement that corporate professional trustees to ensure all of their directors are 'natural' persons.
- **Summer 2023** - Royal Assent for the Finance Bill bringing in changes to the Annual Allowance and prospective abolition of the Lifetime Allowance.
- **Summer 2023** – Royal Assent is also expected for the Online Safety Bill.
- **Summer 2023** – The phased compulsory on-boarding of schemes to the pensions dashboard was due to begin, but we are now expecting a revised staging timetable to be published.

- **1 October 2023** – New ‘AS TM1’ assumptions for money-purchase illustrations.
- **October 2023** – the new DB scheme funding regulations should be available with new requirements coming into force for schemes with valuation effective dates from April 2024.
- **Autumn/Winter 2023** – revisions to scheme and employer-related events notifiable events, we well as the introduction of new declarations of intent.
- **Autumn/Winter 2023** – Royal assent for the Data Protection Bill is expected, which will replace the EU’s data protection laws following Brexit.
- **6 April 2024** – the Lifetime Allowance will be abolished.
- **Summer 2024** – Requirement for schemes, with more than 100 members, to undertake their first Own Risk Assessment (ORA) and publish it by April 2025.

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