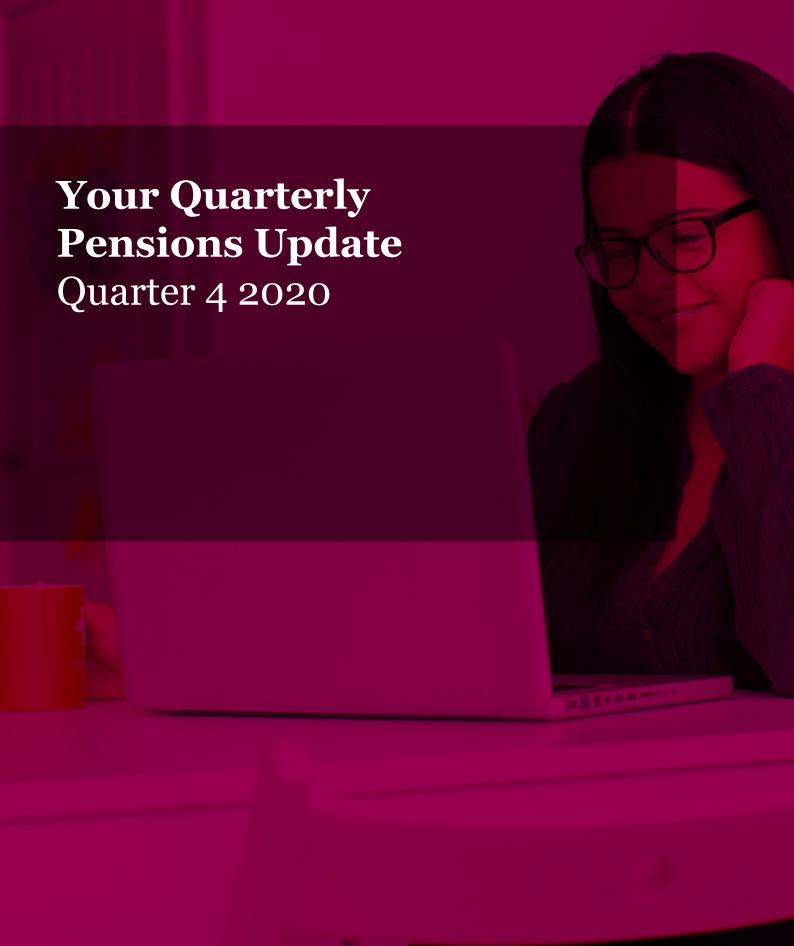
## **SPENCE**



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### Welcome to your Quarterly Pensions Update

## The purpose of this report is to update sponsors and trustees with recent pensions industry changes in the quarter.

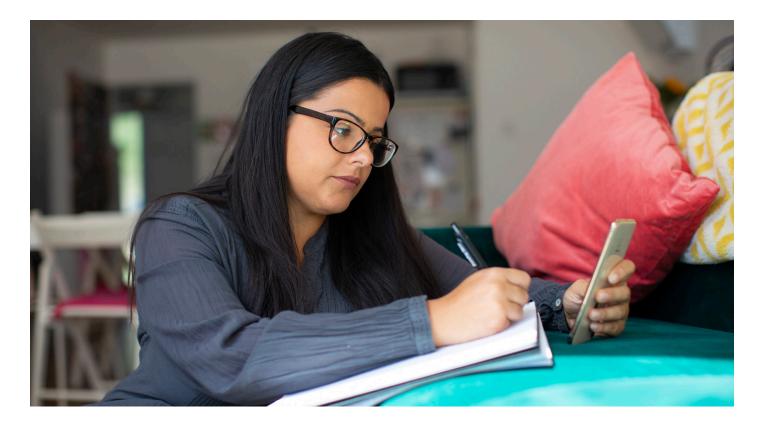
For your convenience, Spence has summarised the key developments and highlighted the necessary actions sponsors and trustees may need to take.

The report combines brief written comment with links to any further relevant information and any deadlines you should be aware of. We trust you will find the update useful and informative. If you require further information about how any of the topics covered might impact on your scheme specifically, please get in touch with <a href="https://hugh.nolan@spenceandpartners.co.uk">hugh.nolan@spenceandpartners.co.uk</a> or your usual Spence contact.

#### **NOTE**

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

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



### Lessons learned

#### A review of pension developments in 2020

Whilst many of us will simply want to forget about 2020, it was, at least from a pensions perspective, a year that should be remembered not just because of Covid-19 and the acceleration of a 'new normal' in terms of remote working.

#### **Pre-pandemic**

Even before the global pandemic led to a three-month lockdown across the UK, in the first quarter of 2021, we saw a new Pensions Schemes Bill being introduced into Parliament (although, technically, it was a re-introduction following the dissolution of Parliament at the end of 2019) and a significant milestone for the Pension Protection Fund (PPF) as The Carillion Rail (GTRM) Pension Scheme became the 1000th scheme to transfer to the PPF since its inception in 2005.

How important is this 'lifeboat' going to be when the economic fall-out from the pandemic becomes clear?

The Courts were kept busy in the first few months of the year too, with trustees and sponsoring employers seeking clarification on the correct measure of price inflation for increases to members' pensions in payment. As we will see, pension indexation, is an issue that arises later in the year too.

The Pensions Regulator (TPR) kicked off 2020 in earnest with the publication of the first stage of a major consultation on its revised Code of Practice for defined benefit pension scheme funding.

And HMRC finally got round to providing guidance on the pension tax implications of addressing inequalities arising from Guaranteed Minimum Pensions (GMPs) following the 2018 Lloyds Bank Pension Scheme case.

Yes, it really was over two years ago that trustees were directed to equalise for GMPs and, yet, many schemes have still not started their equalisation projects.

The Budget brought further pension tax changes with a reduction in the Tapered Annual Allowance from £10,000 to £4,000. Further tinkering with pensions tax relief, perhaps as early as Budget 2021, seems inevitable.

There were also 'Brexit developments' with The EU (Withdrawal Agreement) Bill receiving Royal Assent and paving the way for the UK to leave the EU on Friday, 31 January, at 11pm, subject to a transition period until 31 December 2020.

This was all before the Prime Minister told us to 'stay home, protect the NHS and save lives'.

#### First responses

In the second quarter of 2020, TPR's annual funding statement provided information on the completion of valuations in the Covid-environment and the Regulator also separately provided specific guidance designed to help pension scheme trustees and employers cope with the financial and practical impacts of Covid-19.

New legislation was another response to the pandemic. In particular, the Corporate Governance and Insolvency Act, designed to give struggling employers some breathing space, had important implications for pension schemes and the security of members' benefits.

'Superfund guidance', setting out TPR's expectations for DB consolidators was prompted, in part, by the pandemic too.

And the High Court held, in the Hughes case, that the PPF compensation cap was age discriminatory. A government response to this decision is still awaited as the judgment has been appealed.

#### A 'new normal'

This was all before the second half of 2020, where some semblance of normality resumed (at least for a period) after a three-month lockdown.

From a pensions perspective, the key development in the third quarter of 2020 was probably the consultation on taking action on climate risk and improving governance and reporting by occupational pension schemes. Climate change is an issue which trustees will be hearing a lot about over the coming months and years.

Turning then to the final quarter of 2020, The Pension Schemes Bill, mentioned at the start of this article, is close to Royal Assent.

Trustees and employers should already be thinking about the Bill's provisions on funding, new powers for TPR and 'climate change' (see the paragraph immediately above).

TPR asked us to "pledge" to combat pension scams and, on a related note, the High Court clarified how the legislation governing the Fraud Compensation Fund should be interpreted, providing some hope of redress for those who have lost £millions by becoming victims of pension scams.

In probably the last significant case of 2020, the High Court also told us, in the second Lloyds Bank Pension Schemes case, that trustees of DB schemes, which provide GMPs, are required to revisit and, where necessary, top-up historic cash equivalent transfer values that were not already equalised for GMPs.

So, action is needed to equalise for GMPs in respect of the past and future.

And, in the final substantive development at the time of writing, the Government confirmed that the Retail Prices Index will be reformed to align with the Consumer Prices Index, including owner occupiers' housing costs, but not before February 2030.

#### Winds of change

What can we expect in 2021? Well, that question probably warrants an article in its own right (and I am sure it will get one) but, as we reflect on the year that was, it seems evident that, in the pensions world, the one thing we can be sure of is change.



### **GMP** Equalisation and Historic Transfers

#### **Overview**

A further hearing was held in 2020 in the Lloyds GMP equalisation case. The hearing covered historic transfers out of the Lloyds schemes, because this issue was 'carved out' of the original judgment in 2018.

The Judge ruled that past statutory transfers, which have not been equalised for the effects of GMPs, should be revisited and equalisation payments made either to the receiving schemes or direct to members.

#### **Detail**

- The transferring trustee committed a breach of duty in paying an inadequate transfer value and remains liable to the member.
- In respect of individual transfer payments made under the cash equivalent transfer value (CETV) legislation,
   the transferring trustee owes an obligation to the transferred member in relation to transfers to all of the types of pension arrangements. This is to be satisfied by way of a top-up payment.
- All top-up payments should bear interest at 1% above base rate and be paid from the assets of the scheme.
- The transferring trustee's obligations are not relieved by the discharge provisions in the CETV legislation or the Limitation Act 1980.
- The forfeiture provision under the scheme rules does not apply in this case.
- There is no requirement to top-up 'rules based' (i.e. non-statutory transfer values paid under the scheme rules), as under preservation legislation the member no longer has rights in the scheme. Bulk transfers carried out on a mirror image basis also do not need revisited.
- Transferring trustees need to be proactive in that they must consider the following to determine what to do:
  - o the rights and obligations identified;
  - o the remedies available to members;
  - o the absence of a time limit.

The judge was asked not to reflect on the wider consideration of administrative costs.

#### **ACTION**

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

Employers should consider if the annual accounting figures will need to include an additional adjustment in respect of top-ups to past transfers.



High Court Judgment Template (bailii.org)

### Pension Scams - Key Developments

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

#### The Pledge

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

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

Minister for Pensions and Financial Inclusion, Guy Opperman, said: "I would encourage all pension providers, trustees and administrators to pledge their commitment to this campaign and help do their bit to crack down on pension scams". Trustees, advisers and providers can sign up to the pledge through the TPR website (see Useful Links below). Spence will be signing up to the pledge and self-certifying in due course.

#### **MEETING THE PLEDGE**

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

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

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

#### **Scams Module in the Trustee Toolkit**

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

identify the common warning signs of a pension scam;

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

As part of our actions towards self-certifying adherence to the Pledge, Spence are making it a requirement for all staff involved in pensions delivery and consultancy to complete the module.

#### **FCF Judgment**

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

#### **Background**

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

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

#### The Judgment and Next Steps

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

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

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

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

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

#### **Other Developments**

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

In a welcome move, to give the industry more power to put a halt to suspect transfers, the government intends to implement new regulations as part of the Pension Schemes Bill. Specifically, the regulations will remove the statutory right to transfer when certain "red flags" exist and will apply to both DB and DC schemes. While the

details have yet to be clarified by the government, PSIG and the WPC have identified typical "red flags" as being:

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

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



#### **Helpful Links**

Join the PSIG

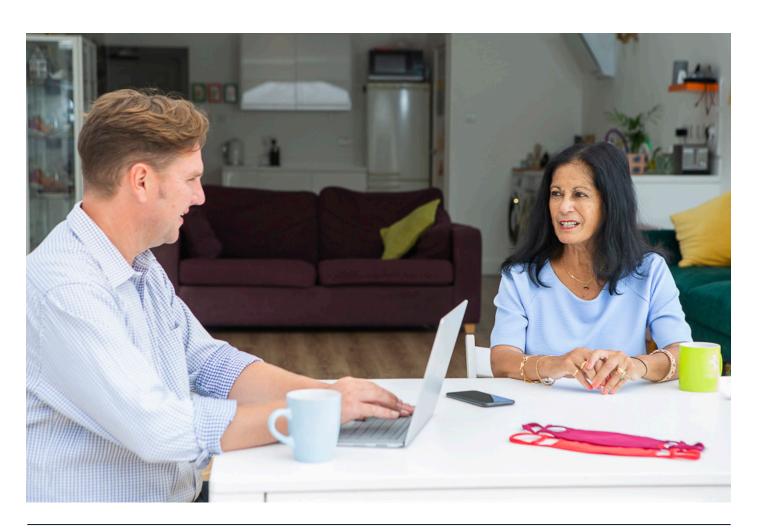
Trustee Toolkit - Scams module

TPR Guidance on Pension Transfer Due Diligence

PSIG code

**TPR - Scams Information** 

FCA's ScamSmart website



### 2020 Q4 Investment Update

#### **Investment Market**

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

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

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

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

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

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

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

#### The CMA Order

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

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

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

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

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

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

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

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

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

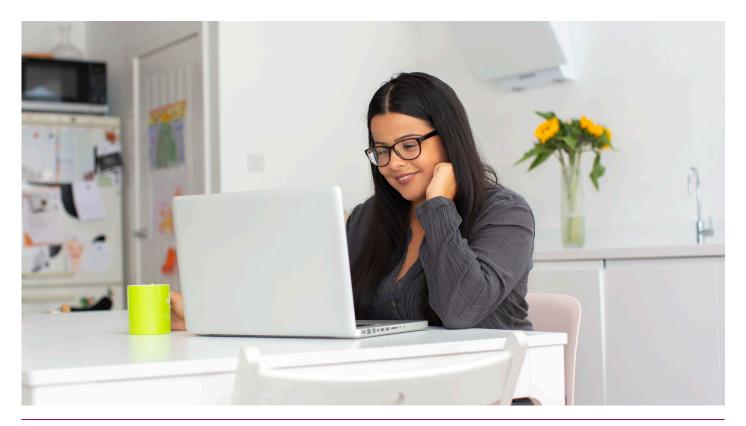
Schemes with a FM in place should consider the circumstances that apply to their appointment and put in place processes to monitor compliance with the re-tendering requirements. Trustees should consider the length of time it will take to run the tender exercise and plan ahead.

#### **ACTION**

Trustees should review their investment management arrangements to ensure compliance with requirements of the CMA Order.



Tender and set objectives for investment service providers | The Pensions Regulator



### TPR 'Distressed Employer'

#### Overview

New guidance from the Pensions Regulator (TPR) urges trustees of defined benefit (DB) pension schemes to prepare now in case their sponsoring employer faces financial difficulties. It sets out how trustees and employers should work together to make the right decisions for a pension scheme - monitoring the covenant and adopting an integrated risk management (IRM) approach, even if the employer is not currently in trouble. Key points are:

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

#### Detail

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

It begins by observing that "When sponsoring employers experience financial distress, actions taken by those employers as a result can lead to significant pension scheme losses. It is during these times that options available to protect savers and their pension schemes reduce as the sponsor moves along the stress curve towards insolvency". As "the first line of defence for savers and their pension schemes", TPR expects that they will "remain alert, prepare, plan and [be] ready to act as the economic impact of global events develops".

The concept of a corporate stress curve is used to illustrate a hypothetical employer's downturn towards insolvency and highlights the steady decrease in options for trustees as a sponsor becomes more distressed. Moreover, it picks out strategies that trustees should focus on, depending on where their employer sits along the curve. The stress curve divides sponsors into three groups with recommendations for each group. Some key points are shown in the table below (the guidance is much more detailed and includes links to relevant guidance such as clearance, notifiable events and protecting savers from scams).

Group	Best Practice
Sponsor showing no signs of distress	IRM processes in place
Sponsor showing signs of distress	Know the signs (see Annex 2 of the guidance)  Understand the potential returns to the scheme in a theoretical insolvency  Increased frequency of covenant monitoring and review investment strategy  Understand the interests of other stakeholders (e.g. banks and other creditors)
Distressed sponsor facing prospect of insolvency	[The above, plus] Engage with the PPF  Develop communication strategy for members

#### ACTION

A key message is that trustees should act now to ensure they are prepared for the risk of employer distress and have more protections or triggers in place to protect their schemes from any negative impact in the event the worst-case scenario materialises.

Ideally, as a minimum, trustees should seek to ensure they are provided with early information that explains the deteriorating nature of their sponsors performance, preferably before and not after stress turns into distress, enabling them to take advice and consider protective actions to avoid the risk of being placed last in the queue of creditors.

#### Good advice is paramount.



<u>Protecting schemes from sponsoring employer distress | The Pensions Regulator</u>

**PPF Contingency Document** 

TPR Trustee Checklist to reduce list of sponsor distress

TPR's Corporate Stress Curve

Clearance | The Pensions Regulator

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

Protecting savers from pension scams (thepensionsregulator.gov.uk)

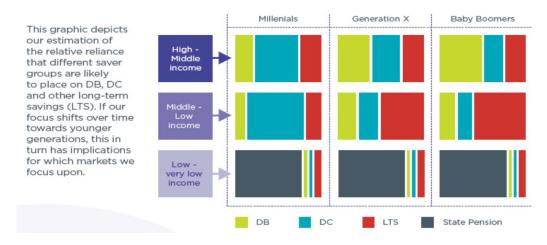
### The Pensions Regulator 15-year strategy

#### **Overview**

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

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

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



For younger savers automatically enrolled into DC pensions, it is observed that 'investment performance', 'value for money' and 'at-retirement decision-making' will play a much greater role in retirement outcomes. From this analysis five strategic priorities emerge:

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

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

#### What can we learn from this paper?

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

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

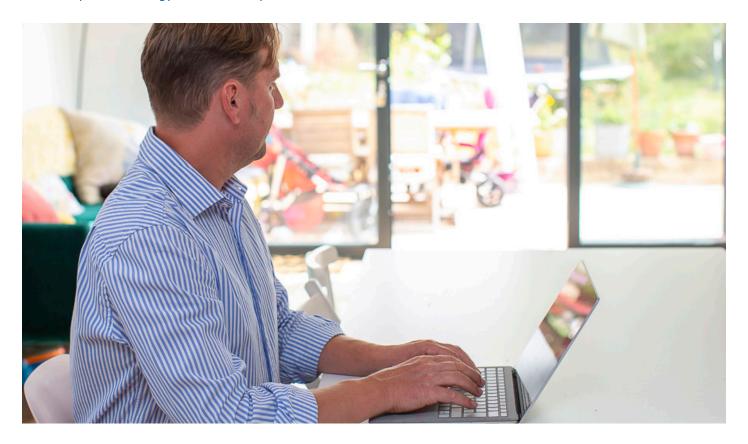
Of course, the adage 'we live in interesting times' has never been more apt and so it is important to note that the strategy paper is specifically stated to be a 'living document'. Spence and Partners have made representations in respect of the four substantive issues raised by TPR.

#### **ACTION**

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



TPR's Corporate Strategy Discussion Paper



### Cyber Security and administration

As we continue to work from home, the risk of being victim to a Cyber security attack remains higher than ever. The pensions administration industry has access to 'rich' personal and financial data and is therefore highly vulnerable to attacks. With thousands of administrators suddenly and unexpectedly thrown into working from home situations, and data being accessed by many people from many different locations, this has had a significant impact on what was already a very problematic issue pre COVID 19.

Two main cybercrime techniques are 'phishing' and the insertion of ransomware into a computer. Cybercrime is different to fraud, it involves illicit intrusions into computers and networks (hacking) and/or the disruption of computer functionality, such as malware, ransomware and Distributed Denial of Service ('DDoS') attacks. Data stolen by means of cybercrime can then be used for fraudulent purposes.

Towards the end of 2020 the Pensions Administration Standards Association (PASA) issued updated guidance aimed at helping administrators by outlining four key areas covering different elements of cybercrime: meeting legal and regulatory standards, understanding their organisation's vulnerability to cybercrime, ensuring resilience, and finally in case of an attack, remaining able to fulfil critical functions. Other bodies, such as the Pensions Regulator have issued their own guidance.

Like PASA, Spence is very aware of current heightened interest from cybercriminals in the pensions sector. This has the potential to have a very serious impact unless administrators are properly protected because of people's reliance on them to settle and pay their benefits from pension schemes. We are pleased to confirm that our market leading systems and processes meet the guidance from PASA and, in many cases, exceed it. Our administration staff receive regular training and updates on this matter to keep them aware of the warning signs of cyber security scams and common preventative measures.

#### **ACTION**

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



Cybercrime Guidance - November 2020 - The Pensions Administration Standards Association (pasa-uk.com)

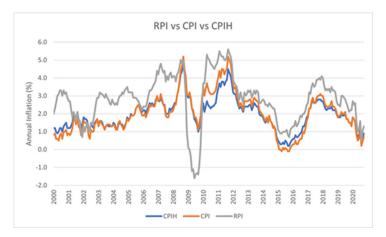
### Reform of RPI

#### RIP RPI?

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

#### **Background**

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



#### What does it all mean?

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

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

- Assets: Where a scheme has benefits linked to inflation, index-linked gilts have been a popular "matching" investment. Changing RPI to CPIH will result in an expected reduction in future payments received on index-linked gilts, which will have implications for the value of those assets. Schemes that hedge their inflation risk through LDI investment will be similarly affected. The Government has confirmed there will be no compensation for this.
- Liabilities: As there are no CPI-linked government assets, it has been common practice for actuaries to set CPI assumptions relative to market information on long-term expectations for RPI. Prior to the consultation, it was common to assume that the long-term gap between RPI and CPI rates would be around 1% a year. With RPI effectively reducing from 2030 and CPI unchanged, the gap between RPI and CPI will narrow. As such, actuaries will revisit their CPI assumptions to ensure these are not too low (which, if left unchecked, would lead to an understatement of liability values).

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

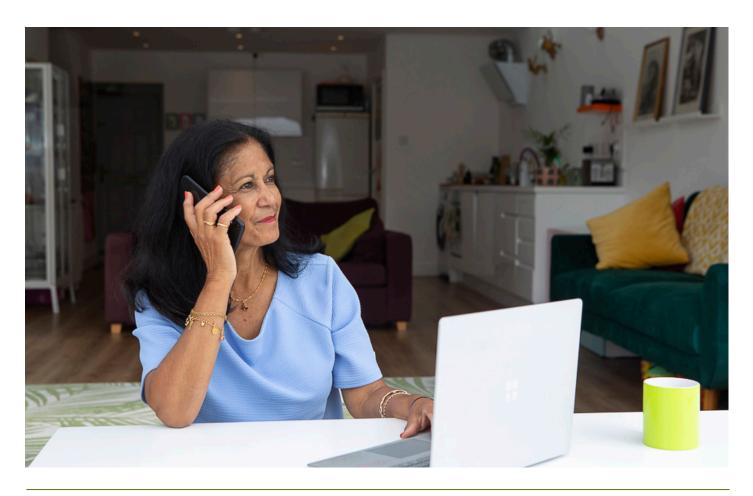
#### **ACTION**

Consider impact of prospective change on your scheme, in terms of both assets and liabilities



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

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



# Guidance for trustees and employers on DB Superfunds

Following on from its interim guidance for Defined Benefit ('DB') superfunds, The Pensions Regulator (TPR) released guidance for trustees and employers considering a transfer to a DB superfund in October.

In its guidance, TPR set out 3 gateway principles for a transfer to a superfund. A transfer to a superfund should only be considered if the following principles are met:

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

#### **Guidance for trustees**

When considering a transfer to a superfund TPR expects trustees to carry out their own due diligence and demonstrate that thorough consideration has been given to their decision. Trustees should obtain appropriate professional advice when considering and undertaking a transfer to a superfund, this should include actuarial, covenant and legal advice. Given the complexity of the decision, trustees should consider whether they have the necessary knowledge to make the decision, and if not should consider appointing an independent trustee. As part of the due diligence, trustees should consider the following:

- Other options to improve the scheme's position.
- Whether the superfund is the right place for members given their circumstances.
- What the outcome of TPR's assessment of the superfund is.
- How the superfund will operate including issues such as funding, investment strategy, fees.
- Whether conflicts of interest are appropriately managed.
- Whether they and their advisers are comfortable with the results of any modelling carried out.
- Whether the transfer is in line with the gateway transfer.
- Any risks created by the transfer for either transferring or remaining members in the scheme.

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

#### Guidance for employers

In addition to providing additional capital necessary to meet the entry price to a superfund, employers will have a key role in ensuring that all of the necessary information is in place for a transfer to a superfund, as well as being an 'applicant' for clearance of the transaction.

While the decision to go ahead with a transfer to a superfund will lie with the trustees, the employer will have a key role in gathering and providing information to the trustees to enable them to make their decision. The employer should ensure that the trustees have all they need – including time, resources, and information – to consider a transfer. TPR expects employers to pay for any professional advice that trustees need to inform their consideration of the transfer, including reports into the employer's covenant. Employers should also seek their own advice on the transaction.



DB superfunds guidance for trustees and employers | The Pensions Regulator

### Post Brexit impact on pension schemes

#### **Overview**

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

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

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

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

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

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

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

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

#### **ACTION**

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

### Coming up next...in 2021

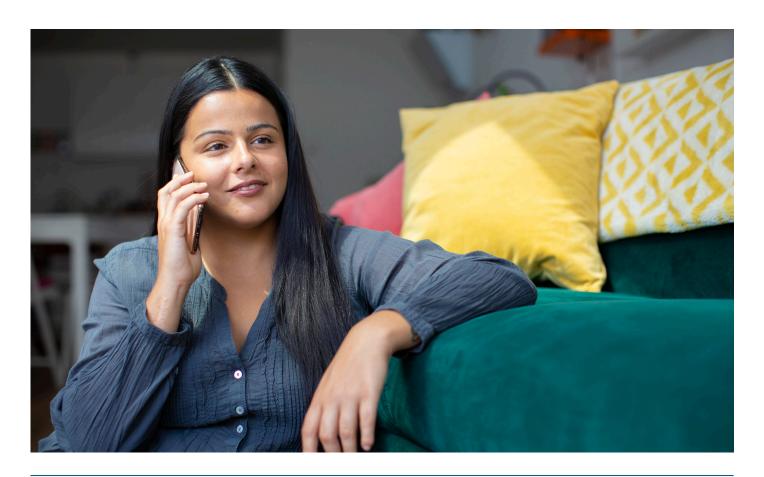
Normally our quarterly update would wrap up with a summary of the events on the horizon in the next quarter. However, for a slight change, we thought we would cast our gaze slightly further by considering the events that we expect will march into the foreground during the course of the next year. Given this report started with a look back over the year that was, we thought ending with a forward look to the year ahead will bring some nice symmetry.

- Pensions Schemes Bill 2019-21 At the time of writing the Bill has been returned to the House of Lords for consideration on 19 January 2021 of amendments by the House of Commons. Royal Assent should therefore soon follow, bringing with it considerable changes, ranging from collective DC arrangements to new Regulator powers, as we discussed in our second quarterly update of 2020 <a href="here">here</a>. Following enactment into law, the focus will then turn to supplementary regulations to provide more detail and substance, not least of which will be the regulations clarifying how the statutory right to a transfer might be denied by trustees if certain "red flags" are identified (as discussed earlier in this report). It is also worth remembering that the Pensions Minister has promised a second Pensions Bill, hot on the heels of enactment of the current one, that will put in place a legislative regime for DB superfunds.
- Target End States for DB Schemes The Institute and Faculty of Actuaries ("IFOA") recently released a paper setting out the issues to be considered by trustees, employers and their advisers when setting the 'Target End State' ("TES") for their scheme. The Pensions Schemes Bill will introduce a requirement for trustees to set a long-term, integrated strategy (i.e. funding and investment) for how the scheme can reach its TES and articulate this in their triennial actuarial valuations. The IFOA's paper sets out the issues to be addressed when deciding whether the TES should be low-dependency, buyout, or transfer to a superfund, with member outcome analysis being identified as a central tool in this decision making. A 5-step approach is set out, with further advice on the role of the actuary, how trustees should review their TES and the importance of preparing data and benefit tasks. While little focus has been placed on setting a TES in the past, it seems 2021 will push the topic to the forefront for DB scheme trustees and sponsors.
- The Triple Lock and Tax Relief on Pensions With the roll-out of the Covid-19 vaccine underway and the return to some form of normality at least visible, the resident of 11 Downing Street will be looking for areas of the economy to claw back some of the huge expenses of the pandemic (over £300 billion at the time of writing). It has been widely speculated that two areas that might provide some savings for the government are the pension savings of the higher earners in society and the triple-lock applied to the current generation of state pension recipients. Both policies have been mooted for years as avenues for the government to make significant savings (abolition of higher rate tax relief could generate £10 billion per annum) and the unprecedented costs of 2020 may well see 2021 as the year that speculation becomes reality.
- PPF levy determination for 2021/22 The PPF has set its levy estimate for 2021/22 at £520 million, which represents a £100 million reduction on the previous period, recognising that employers and schemes are under strain in the current climate. In particular, the PPF has halved the risk-based levy for the smallest schemes, to acknowledge that those schemes are most vulnerable to significant fluctuations in expenses, such as the levy. However, the PPF has stressed that this reduction in 2021/22 will not necessarily limit any potential increases in the following levy year. This will entirely depend on whether 2021 sees the increase in PPF claims that many are expecting.
- Pension Scams Our lengthy article earlier in this report detailed the efforts being made by TPR to tackle the scourge of pension scams, with the pledge to combat scams being front and centre. The first wave of pension scammers was born out of the financial crisis of 2008/2009, with those individuals who found themselves under severe financial pressure as a result being enticed into transferring their pensions under the promise of guaranteed returns. The pandemic is likely to create a fresh cohort of people under financial strain, who will be just as vulnerable to the unscrupulous scammers, who are constantly changing their tactics to find new ways of stealing hard earned savings. So we expect 2021 to bring a much welcomed, and much needed, tougher stance on preventing scams, with ceding schemes in particular being expected to implement tougher due diligence when it comes to member transfer requests.

- TPR's Funding Code Consultation, Part II The interim response from TPR to the first stage if its revised DB funding code consultation was published recently, albeit it was only 6 pages in length. General support for the principles in the funding code was expressed, but TPR recognised that the 127 responses to the consultation did raise concerns as to how those "principles would be applied in practice through the twin-track regime (Fast Track and Bespoke)". The second half of 2021 will therefore see the next stage of the funding code consultation, which will include a summary of the first round of responses, a draft code of practice for consultation, and an impact assessment of the proposals. The new code may not come into effect until 2022.
- TPR's Trustee Knowledge and Understanding ("TKU") Consultation 2021 will bring no shortage of consultation work for TPR it seems, with the first half of the year expected to see the release of its 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.
- Competions and Markets Authority (CMA) Order and Climate Risk Governance 2020 saw the implementation of many new requirements, not least regarding the publication of online Statements of Investment Principles, Implementation Statements and Compliance Statements. While those many statements may have been made, 2021 will see further requirements in relation to trustee investment and governance duties. For example, schemes with fiduciary managers in place (for more than 20% of their assets) may need to complete a competitive compliant tender process by 10 June 2021 (subject to some conditions that trustees should review urgently with their investment advisers). Also, as of 1 October 2021, large pension schemes (in excess of £1 billion of assets), authorised master trusts and collective money purchase schemes will need to have in place their climate risk governance measures and publish climate risk disclosures.

Away from pensions, investments, consultations and regulations for a moment, we are acutely aware that this next year will bring more challenges for us all personally. At the time of writing, the pandemic is at another peak and the darkness of 2020 has undoubtedly lingered through to 2021. Yet there is a chink of light piercing that darkness, with the vaccine finding its way to more and more of our vulnerable citizens and key workers.

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



### **SPENCE**

#### **Belfast**

Linen Loft 27-37 Adelaide Street Belfast BT2 8FE

T: +44 (0)28 9041 2000

#### Bristol

Castlemead Lower Castle Street Bristol BS1 3AG

T: +44 (0)117 959 5002

#### Glasgow

The Culzean Building 36 Renfield Street Glasgow G2 1LU

T: +44 (0)141 331 1004

#### London

46 New Broad Street London EC2M 1JH

T: +44 (0)20 7495 5505

#### Manchester

82 King Street Manchester Lancashire M2 4WQ T: +44 (0)161 641 6312

#### Birmingham

Edmund House 12-22 Newhall Street Birmingham B3 3AS T: +44 (0)121 389 2314

#### Leeds

Princes Exchange Princes Square, Leeds West Yorkshire LS1 4HY

T: +44 (0)113 426 4487

spenceandpartners.co.uk