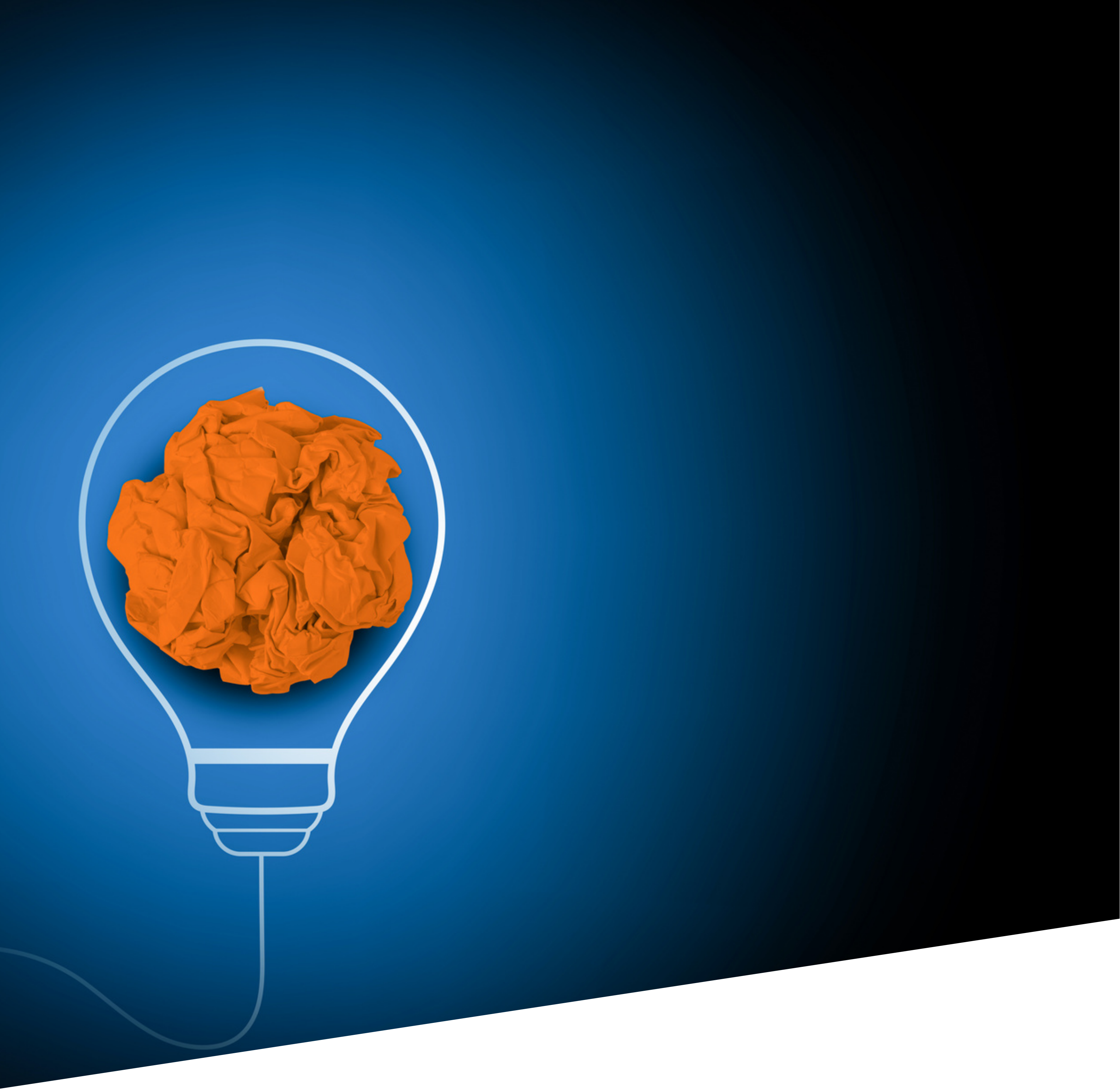

INSIGHT

DEVELOPMENTS IN OCCUPATIONAL PENSIONS

JULY 2023

hughespricewalker

CONTENT

ANNUAL FUNDING STATEMENT (AFS) 2023

The Regulator publishes a statement each year on how it expects trustees to approach current actuarial valuations. The latest statement was published in April 2023 and can be found at the following link: https://www.thepensionsregulator.gov.uk/en/document-library/statements

Key points include:

General considerations

- Funding positions for the majority of schemes should be ahead of plan due to a combination of investment out-performance from return-seeking assets and a significant rise in gilt yields.
- Trustees should consider whether their long-term targets remain appropriate and whether buy-out is viable. Trustees should also consider whether continuing with the existing strategy and level of risk is in the best financial interest of members and beneficiaries.
- For the minority of schemes that have seen a reduction in funding levels, funding and investment strategies should be reviewed and reset if necessary to ensure the trustees' long-term target is reached.
- The impact on assets, liabilities and covenant might be different in the short and long term so should be considered in an integrated way. Scenario planning could help with strategic de-risking, journey planning and contingency plans.

Funding position

- There is different guidance for schemes with funding levels which are (i) at or above buy-out, (ii) above technical provisions but below buy-out, and (iii) below technical provisions.

- **Funding levels at or above buy-out:**

1. Trustees may need to take advice and consult the employer before buying out the liabilities with an insurance company.
2. Trustees might decide that running on the pension scheme is a better option for members as it offers them the potential to benefit from future surpluses in the scheme. Trustees should however be aware of the risks involved e.g. investment risk, longevity risk, expense risk.
3. If buy-out is the preferred option, the scheme's investments should be in assets preferred by insurance companies which can be discussed with the trustees' investment adviser. Data should also be reviewed and improved if necessary. Trustees can refer to the Pensions Administration Standards Association's guidance on buy-out data for further information.

- **Funding levels above technical provisions but below buy-out:**

1. Having a funding level above technical provisions should prompt trustees to strengthen the technical provisions and reduce risk in the investment strategy, in particular trustees of schemes which experienced a significant improvement in the funding level.
2. Trustees should consider the steps they can take to align with the key principles of the draft DB funding code, in particular those relating to the long-term objective, investment allocation and funding basis.
3. The comments for schemes with funding levels at or above buy-out are applicable to schemes falling into this category which are well on their way to reaching the buy-out funding level and which have buy-out as their long-term objective.
4. Trustees should agree a long-term objective as a priority and, if the funding level is already above the chosen long-term objective, consider reducing the scheme's ongoing reliance on the employer.

- **Funding levels below technical provisions:**

1. Trustees' main focus should be on bridging the gap between the current funding level and the technical provisions. Any deficit should be recovered as soon as the employer can reasonably afford.
2. If the funding level improved in a slow and steady manner, trustees might consider that their strategy is working according to plan and therefore no change is required if the employer's covenant is unchanged or similar.
3. If the funding level improved significantly, trustees might consider applying some of the funding gains towards a less risky funding and investment strategy.
4. If the funding level reduced, trustees should seek to understand the reasons for the reduction then review and reset the funding and investment strategy if necessary.

Investment strategy

- For many schemes, the current asset allocation may be significantly different compared to where it was expected to be so the investment strategy should be reviewed.
- Trustees should consider the implications for their investment strategy, in particular the split between matching and growth assets and possible de-risking options.
- Immature and open schemes that have seen significant increases in their funding level may have a wider choice of strategies available, including retaining higher levels of risk, compared to more mature schemes.
- Trustees should refer to the Regulator's guidance on using leveraged liability-driven investments. They should also discuss managing illiquid assets with their investment adviser.

Employer covenant

- Trustees should be aware that reliance on the employer covenant can change quickly in volatile economic conditions if the scheme's investment strategy is not resilient to market changes or if the health of the employer's business deteriorates.
- Scenario analysis of different economic environments and their impact on funding positions can help trustees to determine how quickly reliance on covenant can increase.
- Employers should provide trustees with financial projections and business plans to enable trustees to properly assess the covenant. Trustees should also consider obtaining specialist advice.

Revising recovery plans

- If trustees are considering whether to reduce or stop deficit repair contributions as part of an actuarial valuation, they should consider:

1. If the covenant is weak or has weakened, ensuring that the level of prudence in the technical provisions remains appropriate and the level of investment risk is appropriate.
2. If there is a deficit on the technical provisions basis, reducing the remaining length of the recovery plan before reducing the level of deficit repair contributions.
3. If the recovery plan makes an allowance for asset return outperformance, reducing the additional risk from this before reducing the level of deficit repair contributions.

- If trustees are considering whether to reduce or stop deficit repair contributions outside of an actuarial valuation, they should work through the considerations set out above.

DASHBOARD NEWS!

5 June 2023: The Pensions Administration Standards Association (PASA) issued a brief update outlining possible options to co-ordinate Additional Voluntary Contribution (AVC) information for the Dashboards of defined benefit (DB) schemes as follows:

- Single Source (where the DB scheme provides all AVC details)
- Multiple Sources but Linked (where the DB scheme and the AVC provider both submit information which is displayed together)
- Unlinked (where two separate sets of data are held)

PASA announced that it was issuing questionnaires to AVC providers to understand which options they support and then publishing responses to reduce queries received from schemes on this topic.

8 June 2023: In March the Minister for Pensions had announced that more time was needed to deliver the complex technical solution required for pension providers to connect to the dashboard. On 8 June the Department for Work and Pensions (DWP) went on to issue a statement explaining that amended regulations had now been laid before Parliament to replace the original staging timeline set in legislation with an overall connection deadline of 31 October 2026 for all in scope schemes. Guidance rather than legislation will be issued later this year to set out the expected staging timelines for each cohort.

8 June 2023: PASA published comprehensive guidance covering a range of areas that might affect dashboard data, including amongst others:

- Expectations on revalued DB preserved pension values
- Treatment of deferred members who are over normal retirement age
- Benefits that include tranches payable at different ages (for example due to equalisation)
- Benefits with underpins and guarantees (such as Guaranteed Minimum Pension (GMP) underpins or where benefits are subject to a salary link)
- AVCs (to cover both DB and defined contribution (DC) AVCs, plus the issues raised above relating to split admin)
- How to tackle members with multiple memberships in the same scheme
- What to consider where multiple administrators of the same scheme exist (for example this might be where an annuity provider and a DB scheme may both hold records for the same member)

Details of the Dashboard guidance issued by PASA can be found here.

Next Steps

We have been liaising with our software provider on the options available. Your HPW consultant will provide you with updates once guidance on the new staging dates is available to ensure all data is available and in the correct format.

IGNORING ESG FACTORS IS NO LONGER AN OPTION

Despite trustees' concerns around availability and quality of data, effective modelling of outcomes and impacts, the implementation risks of greenwashing and the potential for green hushing – not disclosing their emissions reduction targets to avoid scrutiny – the Pensions Regulator (TPR) feels that climate, environmental, social and governance concerns have been acknowledged by policymakers, regulators and wider industry, so trustees should be able to take the necessary steps in their decision making.

Around 3,900 pension schemes must produce and publish a statement of investment principles (SIP), plus an implementation statement (IS) outlining how certain principles in the SIP have been implemented.
TPR announced in May 2023 that as part of its climate change strategy 2021, it would be checking that all trustees who are required to do so have published their SIPs and ISs so that they are publicly available. TPR will contact trustees where this is not the case.

In autumn 2023 TPR will then start to review of a cross-section of SIPs and ISs. This will be a qualitative review of the climate, environmental, social and governance (ESG) and wider sustainability related provisions disclosed.
The outcome of the review will be shared with the pensions industry and examples of good practice will be published.

Points to note:

- ISs prepared and published for scheme years ending on or after 1 October 2022 should reflect the guidance published by Department for Work and Pensions (DWP) in June 2022.
- TPR will be focusing on the extent to which the DWP guidance has been adopted.
- TPR's aim is to remove vague and generic references in these documents & for trustees to improve their understanding of climate, ESG and wider sustainability issues.
- If TPR finds that no reasonable effort has been made to define policies in the SIP and to report on how those policies have been implemented in the IS, enforcement action may be taken.

VIRGIN MEDIA V NTL PENSION TRUSTEES II

The High Court has made a significant ruling regarding the effectiveness of previous changes made to contracted-out defined benefit (DB) pension schemes. This ruling could pose challenges for trustees, who will need to collaborate with their advisors to assess the impact of this decision on their specific scheme.

According to Section 37 of the Pension Schemes Act 1993, modifications to the rules of a salary-related contracted-out scheme in relation to "section 9(2B) rights" could only be made if the actuary confirmed in writing that the scheme would still meet the required standards.

The Court was asked to consider whether amendments made without the necessary actuarial confirmation were void and to what extent. The Court ruled that when the required actuarial confirmation was not provided, Section 37 rendered the relevant amendment invalid and automatically void. It further determined that references in the legislation to section 9(2B) rights, which necessitated actuarial confirmation, encompassed both past and future service rights.

Additionally, the judge concluded that the requirement for actuarial confirmation applied to all amendments to the rules of a contracted-out scheme, not solely those that could potentially affect section 9(2B) rights negatively. This broadens the scope for amendments to be deemed void in cases where actuarial confirmation is lacking.

The industry will require time to fully comprehend the implications of this decision. While it is uncertain whether the case will be appealed, trustees might be hesitant to take significant action while the possibility of a successful appeal or parliamentary intervention remains. Nonetheless, trustees may want to review past deeds of amendment to confirm whether the necessary actuarial certifications were obtained.

For more information, reach out to your usual HPW contact.

DC TRUSTEES - HOW GOOD IS YOUR DEFAULT STRATEGY?

This is one of the questions the Pensions Regulator (TPR) would like trustees of DC schemes to consider. TPR, mindful that although guidance to DB schemes on stress testing LDI portfolios had been well received, reiterated its concerns that DC schemes should also aim to protect savers from market volatility, especially those approaching retirement, in a statement released on 6 June 2023.

TPR reminded schemes of their fiduciary duty to ensure lifestyle funds remain appropriate, and to review investment strategies with the emphasis on good member outcomes rather than costs. Interest rate rises impacting long-duration bonds mean that trustees should be looking at their default pre-retirement strategies to ensure the correct outcomes are still being targeted.

Trustees are legally required to review their default strategy and the performance of their default arrangement at least every three years, and without delay following any significant change in investment policy.

TPR asked trustees to consider how they engage with members regarding annual benefit statements which may have a significant gap between date of the statement and the date of issue. Trustees should be mindful of their messaging to prevent knee-jerk reactions where fund values as at the statement date have dropped significantly and the communications provided do not reflect the early signs of recovery. Members should be encouraged to think about their preferred retirement options when they read their annual statement and how their fund choices may impact on this.

Although recent improvements to equity markets mean that younger savers should in theory recover losses over time, those approaching retirement should be encouraged to consider updating their choices and to consider how and when they might like to access their DC pot. TPR stressed the importance of signposting to the free information available from Pension Wise and MaPs as required by the 'Stronger Nudge' regulations to raise member awareness.

HPW incorporated the Stronger Nudge requirements, which include facilitating booking Pension Wise appointments, into our relevant processes, procedures, and communications with effect from 1 June 2022.
If you have any questions regarding your scheme's specific default strategy requirements or the annual benefit statements, please speak to your HPW consultant who will be able to provide you with more information.

PROTECTING SCHEMES FROM SPONSORING EMPLOYER DISTRESS

The Pensions Regulator (TPR) has recently published new guidance for trustees of defined benefit (DB) schemes with the aim to protect schemes from sponsoring employer distress.
The guidance focusses on how all trustees play a critical role in safeguarding savers and their pension schemes and on the importance that trustees stay vigilant, well-prepared, and responsive to any signs of employer distress.

Key messages:

1. It is essential for all trustees to adopt a well-documented integrated risk management (IRM) approach for their scheme, including practical contingency plans and appropriate triggers. By following this approach, potential problems can be identified early on, giving the trustees a better chance to protect the scheme's interests. To ensure effectiveness, regular reviews of risk management and governance procedures are crucial.
2. Staying in frequent communication with the employer and any relevant creditors is crucial for trustees to identify and manage significant risks before they escalate. If the implementation of strong protective measures for the scheme is postponed, it may give other stakeholders, such as lenders, an opportunity to take control over a financially struggling employer. This situation could have detrimental effects on the scheme's well-being.
3. Trustees must remain vigilant against pension scams and unusual transfer activities. Preparing a communication strategy to support savers during uncertain times is vital.
4. If there's a chance that the employer might become insolvent, the trustees should turn to the Pension Protection Fund (PPF) for guidance on contingency planning for employer insolvency. This will help them handle the situation adeptly and ensure the protection of the scheme and its beneficiaries.

This guidance includes some common examples based on what TPR has experienced to date and a useful high-level checklist to use during periods of employer distress.

Mansion House 2023

The Chancellor unveiled a set of innovative 'Mansion House reforms' aimed at unlocking capital within the financial services sector for the most thriving industries.

This initiative will not only boost returns for savers but also support economic growth across various sectors. The government is introducing a range of actions aimed at enhancing the benefits for savers and improving the availability of funding for high-growth companies.

The government has also published a joint consultation response with The Pensions Regulator and the FCA on a new Value for Money Framework for DC schemes.

Annuity incomes hit six month high

Data from Hargreaves Lansdown's annuity comparison tools has shown that annuity incomes are at the highest level since December 2022. At the end of June 2023, the annual annuity income from a £100,000 pension (single life, level, 5 year guarantee) was £7,168 at age 65. Two years ago the same pension would have given an annuity income of just under £5,000.

Managing Pension Schemes Online

HMRC's pension schemes newsletter 150 published on 31 May 2023 announced that for the tax year ending 5 April 2024 (and subsequent tax years), HMRC pension scheme returns should be submitted via the new Managing Pension Schemes service.

Up until now most of the reporting functionality used by DB schemes was still being carried out via Pension Schemes Online.

This new announcement means that from next year those schemes who have not yet migrated run the risk of incurring financial penalties if they fail to make submissions when required to do so.

Trustees should take steps to migrate their pension scheme over from the old Pension Schemes Online service. The requirement is personal to pension scheme trustees. Click here for more details.

Please speak to your Lead Administrator or consultant if you have any questions.

PHONE:
0117 427 8900

EMAIL:
info@hughespricewalker.co.uk

ADDRESS:
Pembroke House 15 Pembroke Road Clifton Bristol BS8 3BA

WEBSITE:
www.hughespricewalker.co.uk