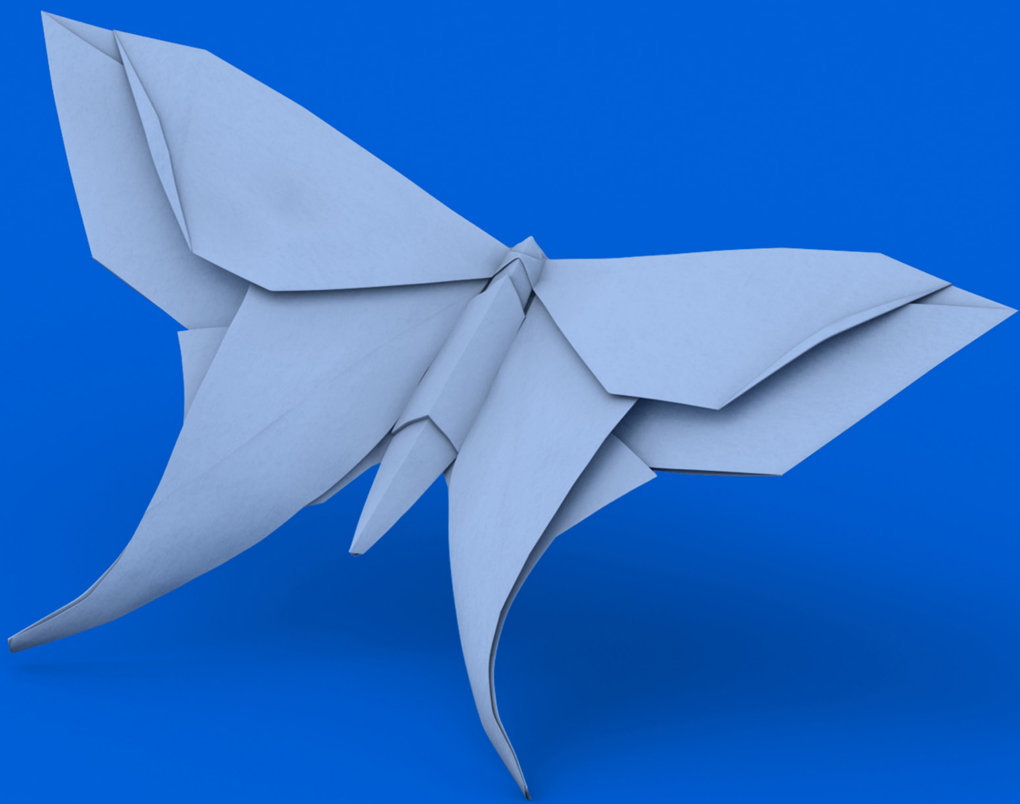
Your Quarterly Pensions Update

Dalriada Trustees – Industry Changes

Quarter Three 2024



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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 Investment Update

Market Commentary

Most asset classes delivered strong returns over the quarter as the start of the US Federal Reserve's ("Fed") rate cutting cycle was welcomed by investors as an indication that it had achieved its aim of combatting the elevated levels of inflation. As a result, Global listed Real Estate delivered the highest returns at 16.2%* with Global Bonds also delivering strong returns at 7.0%* as the prospect of lower rates going forward was positive for valuations. However, the quarter was still punctuated by a bout of market volatility when weak US economic data and an interest rate hike by the Bank of Japan ("BOJ") caused markets to sell-off in early August.

GROWTH ASSETS

Within Equities, Emerging Markets ("EM") was one of the strongest performing regions returning 8.9%* followed by Asia Ex-Japan at 4.6%, after the Chinese Government announced a raft of stimulus measures, which were positive for Asian stocks. Despite most markets performing well in local currency terms, the strong appreciation of sterling during the period dampened the performance of most markets in GBP terms with the Japanese market returning 0.7% and the US market delivering -0.1% for the period. The BOJ's surprise rate hike in July caused Japanese stocks to sell-off and post a negative return in local currency terms. Despite the US Market generating a negative return in GBP, it still achieved a strong return in local currency terms at 5.9%*; US stocks also experienced a broadening out of returns over the period with US Value and Small Caps Stocks posting the highest returns as the dominance of the 'Magnificent 7' (the 7 largest tech stocks in the US market) was reduced. Within Europe, the UK was one of the strongest markets generating 2.3%, whilst Europe Ex-UK was flat for the period with weak German manufacturing data weighing on returns.

Commodity returns were more muted during the period generating 0.7%* as growing concerns around the health of the global economy alongside continued geopolitical troubles in the Middle East weighed on returns, mainly driven by a fall in the price of oil.

Bonds

The start of the Fed's rate cutting cycle meant that most sovereign bond markets posted positive returns this quarter, with Italian Bonds returning 5.2%* and U.S Treasuries 4.7%*.

UK and German Bonds also generated positive returns, whilst Japanese Government Bonds had the lowest returns at 1.5%* as the rate hike implemented by the BOJ weighted on Japanese bond valuations. Credit markets also experienced strong returns during the period with Global Investment Grade and EM Debt experiencing the highest positive returns at 6.3%* and 6.1%* respectively as the more interest rate sensitive credits benefited from the rate cutting cycle, although US and European High Yield also achieved positive returns at 5.3%* and 3.5%* respectively.

Within the UK, long-term UK gilt yields decreased by 0.1% to 4.5% as wider sentiment around potential rate cuts going forward placed downward pressure on rates during the period.

Real yields remained broadly the same at 1.3%.

At the end of the quarter UK long-term inflation remained broadly unchanged at 3.2%.

All returns shown are shown in GBP terms unless stated otherwise, sourced: FTSE, Markit iBoxx

*Local currency, except for EM and global indices, which are in US dollar, sourced: JPM and MSCI

Past performance is not a reliable indicator of current and future results.

Data as of 30 September 2024.

2 DB Funding Code of Practice

After what seems like a very long time, it's finally (almost) here – the new Defined Benefit (DB) Funding Code of Practice from The Pensions Regulator (TPR)!

TPR's new Funding Code was published on 29 July 2024, but before it can take effect, it must be laid before parliament for 40 days. So while it's not expected to formally come into force until late November, it will still apply to actuarial valuations with an effective date on or after 22 September this year. Fear not – TPR has confirmed that it will be in touch with affected schemes to request that they base their valuation approach on the new Funding Code. TPR has also undertaken to adopt a "reasonable" approach towards these schemes' valuations.

The idea of a setting a long-term target and de-risking journey plan, required under the Funding Code, are now well-familiar with Trustees and advisers. However, the Funding Code also brings in a requirement for DB schemes to produce a Statement of Strategy. This Statement is essentially the formal documentation to be submitted to TPR by the Trustees at the end of the valuation process. This will be in addition to existing requirements to prepare a Statement of Funding Principles and a Statement of Investment Principles.

Earlier this year, TPR launched a consultation on the Statement of Strategy. What followed was significant concern amongst Trustees and advisers alike at the sheer volume of information being requested by TPR as part of the Statement. However, TPR has now issued its interim response to the consultation which, thankfully, simplifies the proposed contents of the Statement for many schemes and sets out their revised expectations for Trustees.

Whilst fifteen months for the completion of a valuation may sound like a long time, the new requirements may take some time to get used to, and additional information will be required. Trustees should start to consider at an early stage in the valuation process the data that will be needed to satisfactorily complete their Statement of Strategy. Despite the softening of TPR's stance, it is likely to still be a sizeable document, particularly if Trustees opt to go down the "bespoke route" for their valuation. TPR have helpfully provided templates to be used in the preparation of the Statement of Strategy so Trustees can start to engage with their advisers straight away on any additional work required.

As with most things in DB pensions, the right approach will vary by scheme. This is where a Professional Trustee can add real value to the process – we will know the right questions to ask of advisers and sponsoring employers to help ensure a smooth valuation journey.

3 Restoring Confidence: Compensation for Norton Scheme Members

In recent years, members of three pension schemes, collectively known as the Norton Schemes, faced the reality of potentially losing most, if not all, of their pension savings. These members had transferred their savings over a decade ago, unaware that their funds were unlawfully invested in the sole trustee's business, Norton Motorcycles Holdings Ltd. This breach of trust left many members with uncertainty and significant financial distress.

However, not all was lost. Thanks to The Pensions Regulator (TPR), Dalriada Trustees (Dalriada) and the Fraud Compensation Fund (FCF), managed by the Pension Protection Fund (PPF), a total compensation of £9.8 million was paid to the Norton Schemes between March and July of this year. This development has brought a sense of relief to many affected members and marks a significant step toward restoring their financial security.

The Role of the Fraud Compensation Fund

The FCF, which is funded by a levy on eligible Defined Benefit (DB) and Defined Contribution (DC) schemes, plays a crucial role in protecting members of pension schemes from the financial impacts of fraud. In certain circumstances, where a scheme has been a victim of fraud, the FCF provides compensation to the scheme, so that Dalriada can ensure members still have access to their retirement benefits.

Dalriada has been appointed by TPR to oversee more than 100 schemes eligible to claim from the FCF, which has been pivotal in securing compensation for the Norton Schemes. A landmark Part 8 hearing in 2020 confirmed the schemes' eligibility for compensation, provided certain conditions were met.

Overcoming Complex Challenges

The Norton Schemes, like many others affected by fraudulent activity, were not established or operated in the same way as traditional DC schemes. This has provided complexity to the process of unwinding the damage caused. In addition, the legislative framework governing the FCF was not originally designed with pension scams in mind, which has further complicated efforts to secure compensation.

Despite these challenges, Dalriada and the FCF worked collaboratively to ensure that the affected members of the Norton Schemes could benefit from the available compensation. This achievement highlights the importance of continuous regulatory adaptation and cooperation in addressing the evolving nature of pension fraud.

A New Path Forward

As a result of the compensation awarded, over 200 members can now access their pension benefits through individual policies secured by Dalriada via Standard Life's Master Trust. While this is a significant milestone, Dalriada remains committed to achieving similar outcomes for the thousands of other members across various schemes who have similarly suffered from fraudulent activities.

Though many of our schemes and their members are still on this journey, the Norton Schemes' outcome demonstrates the positive impact that FCF compensation can have on restoring financial stability to victims of pension fraud. This development serves as a vital reminder to the pensions industry of the critical role that robust governance, regulation, and trustee oversight play in protecting scheme members from financial harm.

Conclusion

The resolution of the Norton Schemes case is a testament to the power of collaboration between trustees, regulators, and compensation funds in safeguarding pension members from fraud. As more members of affected schemes begin to see the benefits of FCF compensation, continued vigilance and efforts toward regulatory reform are necessary to protect future generations of savers. Dalriada's efforts in obtaining compensation for the Norton Schemes represent both a significant achievement and a guiding example for other trustees and members who have been affected by dishonesty within their pension schemes.

4 The Value for Money Framework - Proposed Assessment Process

The government is currently consulting on introducing a Value for Money Framework for pension schemes with at least 1,000 members. This consultation is on proposed FCA rules for Group Personal Pensions while the upcoming Pension Bill would apply the same principles to Master Trusts and Single Employer Trusts. The result should be a single regime across all Workplace Pensions.

The Four-Step Assessment Process

Trustees and Independent Governance Committees (IGCs) will be required to assess Value against at least three other Workplace comparators. At least two of these must have Defined Contribution (DC) workplace assets above £10 billion, at least one must be contract-based and at least one must be trust-based.

The assessment against these comparators is a four step process.

STEP ONE – VALUE DELIVERED FROM INVESTMENT PERFORMANCE.

This step focuses on investment returns after accounting for investment charges. Investments returns will be evaluated in the context of the risks taken to achieve those returns, indicating that achieving the same net investment return with lower volatility is likely to be better value for money. Particular emphasis will be placed on investment performance over five and ten year periods.

STEP TWO - VALUE DELIVERED FROM MEMBER SERVICES.

The cost of member services will be calculated on the difference between gross investment performance, net of transaction costs and gross investment performance net of all costs and charges, measured over the previous calendar year. Costs which are not investment costs will be categorised as member service costs.

Member services will be assessed using various metrics, designed to measure:

- transactions are secure, prompt and accurate,
- members are satisfied with the service they receive,
- members are supported to make plans and decisions for retirement,
- members can easily amend their pension (e.g. reviewing beneficiaries), and
- members are supported to engage with their pension.

The evaluation of member value will then involve assessing service quality relative to service cost.

STEP THREE – PROVISIONAL OVERALL VALUE

This combines the findings from the first two steps, concentrating on returns net of all costs and charges over five and ten year periods, alongside a balanced assessment of investment performance, service quality, and costs and charges. This provisional overall value will be compared to the selected comparative schemes. For FCA regulated schemes this assessment differs from the Consumer Duty value assessment which does not necessitate a comparator.

STEP FOUR – RAG DETERMINATION

The final step will take the comparative provisional overall assessment, consider any relevant contextual factors, and determine a RAG (Red, Amber, Green) rating. A green rating indicates Value for Money, an amber rating signifies that Value for Money could potentially be achieved within a reasonable time (e.g. two years), while a red rating suggest that Value for Money is unlikely to be achieved in a reasonable timeframe.

POST ASSESSMENT REQUIREMENTS

Schemes rated amber or red will be required to notify the regulator (TPR/FCA) within five working days and submit an agreed action plan within one month. This action plan will outline either the steps to be taken to achieve Value for Money, or alternative actions such as transferring members to another scheme. Affected employers will also be notified.

Furthermore, it is proposed that FCA regulated firms would not be permitted to accept new employers into amber or red rated arrangements with a likelihood that the same restrictions will apply to Master Trusts.

CONSIDERATIONS FOR STAKEHOLDERS

Although final rules have not yet been confirmed, it may be prudent for stakeholders to evaluate any 'no regrets' actions that can be taken at this stage. If there are particular concerns regarding whether a scheme will be deemed Value for Money, it maybe advisable to expedite any planned scheme reviews to ensure awareness of available options.

Helpful Links

FCA Value for Money Framework

Pensions Regulator press-releases new initiative to check savers are getting value from their pensions

Dalriada. A better way

Belfast

Linen Loft
27-37 Adelaide Street
Belfast
BT2 8FE

Birmingham

Edmund House
12-22 Newhall Street
Birmingham
B3 3AS

Bristol

Programme Building
Spaces Castle Park
Bristol
BS1 2NB

Glasgow

The Culzean Building
36 Renfield Street
Glasgow
G2 1LU

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7 Charlotte Street
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