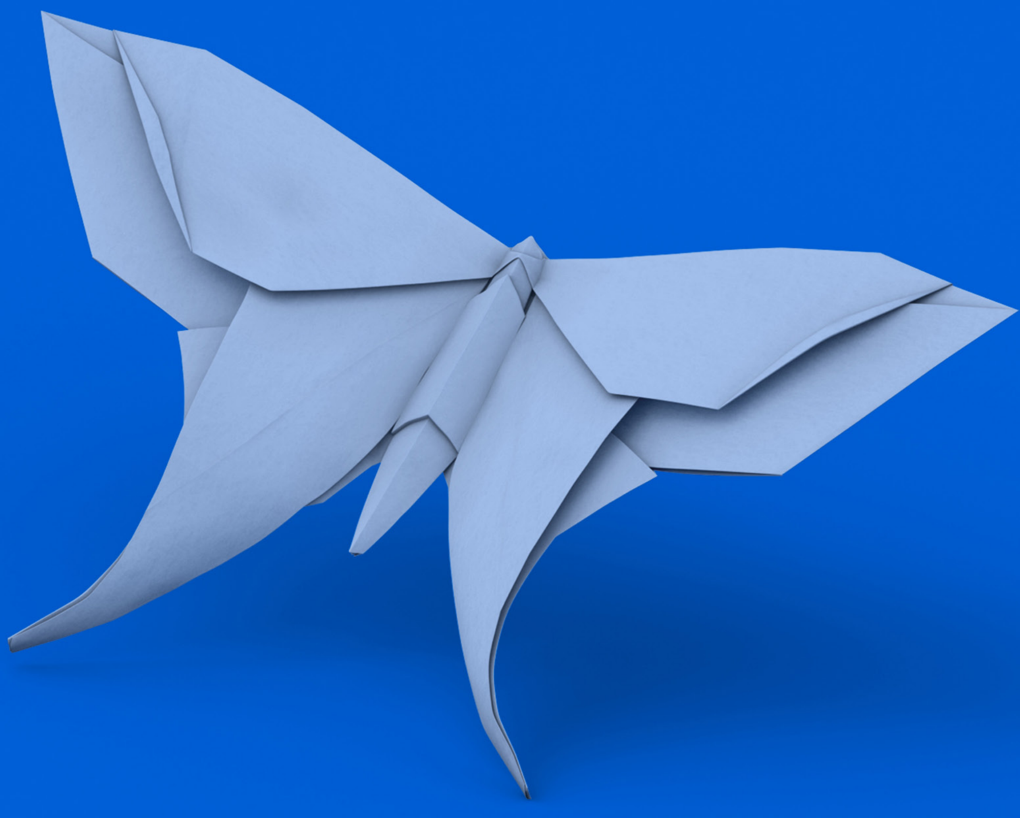
Your Quarterly Pensions Update

Dalriada Trustees – Industry Changes

Quarter Four 2024



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Contents

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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

Global Equities generated a positive return of 5.9% over the quarter mainly driven by the US (which accounts for around 70% of the Global Equity benchmark) and Japanese Equities. In the US, Trump's victory alongside the potential policies he could implement were welcomed by investors, whilst in Japan the weakening of the Japanese Yen in the face of a strong US Dollar was positive for a number of large-cap exporters who were the main drivers of the rally in Japanese equities.

Global Bonds generated a negative return of -5.1%*, with each region experiencing its own idiosyncratic headwinds which weighed on bond valuations.

GROWTH ASSETS

Trump's victory caused EM Equities to fall in value reflecting investors' concerns around the potential impact of Trump's proposed tariffs resulted in Emerging Markets ("EM") and Asia Ex-Japan equities generated the worst returns of all equity markets over the quarter at -7.8%* and -7.4%* respectively. European equities (ex-UK) also produced a negative return over the quarter at -3.8% which was driven by political instability across a number of European countries as well as weak economic data. UK Equities were marginally negative for the quarter at -0.4% with heightened concerns around the growth trajectory of the UK. In stark contrast to the rest of the world, US and Japanese equities rose by 10.0% and 2.8% respectively.

Commodities generated strong returns over the quarter at 6.6%. This was mainly driven by energy and livestock, whilst industrial and precious metals declined. Within energy, natural gas generated strong returns as some supply-chain constraints in the US caused prices to rise during the period. The potential negative impact on Trump's proposed tariffs weighed on copper and nickel prices during the quarter, whilst gold and silver also decreased in value following the appreciation of the US Dollar.

Both Global Listed Real Estate and Global Listed Infrastructure generated negative returns of -8.9%* and -3.1%* respectively this quarter, as the prospect of interest rates remaining higher for longer due to a number of potential inflationary pressures weighed on valuations.

Bonds

Within Fixed-Income, Global Inflation-Linked Bonds declined the most -6.7%* followed by Global Investment Grade -4.0%* and US Treasuries at -3.1%*. Concerns around the potential inflationary impact of Trump's policies negatively impacted the more interest-rate sensitive names within Fixed Income. Conversely, High Yield bonds generated positive returns at 1.7%* in Europe and 0.2%* in the US, as the potential for more pro-business policies under Trump caused credit spreads to tighten which was positive for the asset class.

Within the UK, the Labour government's new budget saw Gilt yields rise, and UK Bonds consequently fall by -3.5%* over the quarter due to concerns over the proposed increases in both taxes and borrowing costs. Despite the Bank of England ("BoE") cutting interest rates to 4.75%, concerns around elevated inflation and wage growth has reduced the chance of further interest rate cuts going forward.

EM Bonds posted a negative return of -2.1%* during the quarter due to two main factors, firstly the strong appreciation of the US Dollar and secondly the potential inflationary impact of Trump's policies which threatens to keep global interest rates at elevated levels going forward.

Within the UK, long-term UK gilt yields increased by 0.5% to 5.0% following the Labour government's new budget which put upward pressure on rates due to concerns around the significant rise in borrowing costs highlighted in the budget. All else being equal, the move will have acted to decrease the value placed on pension schemes' liabilities.

Real yields increased by 0.5% to 1.8%. All else being equal, the move will have acted to decrease the value placed on inflation sensitive pension scheme liabilities.

Long-term inflation remained the same at 3.2%.

All returns 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, S&P and MSCI

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

Data as of 31st December 2024.

2 Mansion House Speech and the ensuing LGPS Consultation

Following the Chancellor's November 2024 Mansion House speech, the Ministry for Housing Communities and Local Government (MHCLG) issued a nine-week consultation[1] which ran from 14 November to 16 January 2025 affecting Local Government Pension Schemes (LGPS). The consultation made proposals covering:

- LGPS asset pooling;
- Local investment; and
- Governance of the pool and fund.

Of particular interest was the section on governance [paragraphs 85-124] which highlighted 11 consultation areas most of which continue themes common across the pension sector for increased standards of governance and transparency.

In some instances, the consultation proposals build upon and improves existing LGPS requirements such as replacing the current governance and compliance statement with a strategy for delivering governance and training amongst those with responsibility for the management and operation of LGPS funds.

Descriptions and the rationale for each proposal can be found by following the link to the consultation which has been included at the end of this article. It is however fair to say that those LGPS that have implemented the findings of the 2021 MHCLG Good Governance Project[2] will already have made progress towards meeting some consultation proposals.

Highlighted below is one example of where the proposed consultation seeks views, and aims to support, LGPS boards and committees in the move towards improved governance and transparency.

Governance and Training Strategy

If implemented, paragraphs 91-94 would require Administering Authorities to prepare and publish their objectives and planned actions for delivering:

- Governance, having regard to statutory guidance
- Knowledge and training
- Representation
- Managing Conflicts of Interest

The consultation further proposes that the strategy is periodically reviewed, proposing that such reviews be aligned to valuation cycles.

HOW THIS PROPOSAL SUPPORTS GOVERNANCE AND TRAINING

Regularly reviewing and updating action plans will ensure strategies remain current and aligning reviews to the valuation cycle should make for a more holistic review and demonstrate how the published strategy might help LGPS and their officials to meet the future needs of members and communities. Additionally, action plans could give greater definition to the strategy and a means of measuring progress.

LGPS boards and committees rely heavily on lay members and elected officials; for some, participation in scheme governance is linked to their term of office. Having effective training strategies and systems of governance in place should act to reduce any impacts arising from losing a pension governance official at the end of their term of office as well as support continuing members.

Managing actual and/or potential Conflicts of Interest in an LGPS environment can give rise to some unique challenges. For example, Senior Officers within the same pool reviewing the operation of each other's pension funds are conflicted although well qualified to undertake such reviews. Having processes and policies in place to manage conflict will be important in aiding transparency.

1 Local Government Pension Scheme (England and Wales): Fit for the future - GOV.UK
2 Good_Governance_Final_Report_February_2021.pdf

LGPS are vast complex schemes governed by a raft of legislation. Across England and Wales, the LGPS have approximately 6.7m members, over 18,000 employers and a market value of c.£392bn at March 2024 so the importance of this consultation cannot be overstated. As with any consultation, there will likely be challenges and amendments before any consultation proposals come into effect; we look forward to the outcome of the consultation and any future changes.

3 Pensions Dashboards – What are we seeing?

The year of the Pensions Dashboard has arrived! April 2025 will see the largest pension schemes connect to the Pensions Dashboard. Each following will see increasingly smaller schemes connecting too, right up until the connection deadline of 31 October 2026.

For many schemes, their "connect by" date will still feel a long way in the future. However, for the many scheme administrators out there, it will be starting to feel very real. Many are building their own integrated service provider (ISP), with others utilising third parties to connect to the dashboard infrastructure. With much connection testing still to be undertaken (the Pensions Dashboard Programme) have confirmed that 8 of their 20 volunteer participants have begun their connection testing, with two having completed it thus far, there is a risk that the industry will not be fully ready to meet individual schemes' connect by dates. Helpfully, there may be some flexibility in connect by dates for schemes should their administrator's chosen ISP not be ready.

As Trustees, we are beginning to see project plans and fee specifications coming from the scheme administrators for nearly all sizes of scheme. Our broad client base allows us to compare and contrast approaches by administrators and sense check their plans and proposed fees, utilising economies of scale where we can.

Our recent discussions with the other industry parties indicate that Additional Voluntary Contributions (AVCs) remain a concern for dashboard connection. Many schemes have little detail of historical AVC arrangements and AVC providers may be unaware of a scheme's dashboard connection requirements. This represents an opportunity for trustees and administrators to get back on track with their schemes' AVCs – engage with their AVC providers (of which there could be many), reconcile AVC data and tidy up any legacy issues.

There does seem to be some momentum in the market now, moving towards the first "connect by" date in April 2025. Hopefully it will continue.

4 Inheritance Tax on Pensions – Taxing times ahead

The government is currently consulting on the administration required due to introducing Inheritance Tax (IHT) on pensions from 6 April 2027.

As this is still a couple of years away, let's start with a brief look at the current position.

Pension assets

Pension scheme assets are excluded from the definition of relevant property and so are exempt from IHT. However, pension contributions, pension transfers and pension payments could be in scope.

Pension Contributions

Employer pension contributions are IHT exempt.

Employee, personal and third party contributions are only exempt from IHT if it is an arm's length transaction not intended to confer a gratuitous benefit on any person. Broadly speaking, this means that if a non-employer contribution is made with the intention of increasing pension death benefits, rather than retirement benefits, then the contribution is potentially IHT liable.

HMRC currently assume if contributions were made more than two years before death, then the member is in normal health, unless there is evidence to suggest otherwise. Such contributions are then considered to be for retirement rather than to increase death benefits

A member being advised to make a pension contribution as part of IHT planning is one example of a contribution which is potentially liable for IHT. A large death bed pension contribution could be another.

Death Benefits

Non-discretionary pension death benefits are treated as part of the member's estate and so are potentially liable to IHT.

Pension transfers

If a member transfers from a pension scheme where there is an existing irrevocable death benefit nomination, the irrevocable nomination falls away. Unless the member then directs death benefits to be paid to their own estate, the change in death benefits could be liable to IHT.

The value of the death benefits will mainly depend on the member's health when they transfer. If the member was in normal health then the value of the death benefits will be negligible. However, if they were in serious ill heath then the death benefits could be worth as much as the transfer value.

April 2027 onwards

The current proposal is that from 6 April 2027 most unused pension funds and death benefits will be included within the estate value for IHT purposes. We don't yet have draft legislation to show exactly how this will be achieved or whether there will be any consequential considerations.

We do know that pension schemes administrators will become responsible for paying IHT on pensions and also reporting to HMRC and Personal Representatives.

Following a death notification, the pension scheme will follow current processes to determine beneficiaries, how benefits will be paid, and, where applicable, whether the benefits are within the member's remaining Lump Sum Allowance and Lump Sum And Death Benefit Allowance. The pension scheme will then share this information with Personal Representatives.

Once the Personal Representatives have received this information from all the pension schemes of the deceased, they will use a new HMRC calculator to determine the proportion of the nil rate band applicable to each pension scheme. The pension scheme will then calculate, report and pay the IHT on the pension benefits, including any late payment interest.

This high level process is still under consultation. There are numerous issues to resolve, mainly around timing, liability and dependencies. HMRC will be responding to the consultation later this year and there will also be a technical consultation on the draft legislation.

So what should schemes do now?

Although these changes aren't due to come in until April 2027 you may have members who are making decisions based on what they think will happen. You may also have members who will be asking for more information.

It's likely to be a while before pension schemes are in a position to make system changes, although any changes will need to be in place by April 2027. In the meantime, we recommend that trustees review the information they currently provide on death benefits to ensure that it accurately reflects the current position and notes that this could change from April 2027.

Helpful Links

Technical consultation - Inheritance Tax on pensions: liability, reporting and payment - GOV.UK

Inheritance Tax Act 1984

5 2024 was a big year for UK pension schemes

We saw the publication by the Pensions Regulator of the long-awaited new General Code, the new DB Funding Code and then, just in time for Christmas, the new employer covenant guidance. DB funding levels remained strong and schemes continued to de-risk and move towards their (perhaps now evolving) end-game. We also saw the abolition of the Lifetime Allowance and the potential introduction of Inheritance Tax on pensions. After much fanfare, we also welcomed the first Superfund transactions and the launch of Collective Defined Contribution (CDC) schemes.

General Code

For trustees, the introduction of the General Code back in March finally answered the outstanding questions on what is expected of a scheme's governance system to make it "effective". For many schemes, this has been simply a refinement of existing policies and practices, but for a very small minority of others, it has required a more thorough re-establishment or re-writing of the overall scheme governance.

The phrase "ESoG gap analysis" came into the regular vocabulary of trustees and advisers alike, featuring in many a meeting agenda at the start of the year. The key here was understanding where your scheme has a "gap" in their governance framework when considered against the new General Code's expectations for an "Effective System of Governance" (ESoG). In many cases, the gaps arose only where trustees and scheme managers had not formally documented a policy or process, but where the practice had already been long established. Putting those policies into writing was an easy win!

Looking ahead, a scheme's ESoG will need to be reviewed at least every three years for effectiveness, efficiency and efficacy. For schemes with more than 100 members, there is also the new requirement to prepare an Own Risk Assessment (or ORA) to determine whether the ESoG is working as planned. We'll no doubt write more about ORAs later this year as the first deadlines for their preparation will start to approach us in early 2026.

With the requirement for a robust and detailed governance framework, the inclusion of a professional trustee on a scheme's board, or the appointment of a sole professional trustee, can simplify the governance processes required. We have resources in place to assist in the management and monitoring of scheme processes, and can utilise our broad client base to recognise best practice and introduce economies of scale. We're also well positioned to consider the Pensions Regulator's expectations on "proportionality", ensuring that schemes are not operating an overly-complex and costly approach to governance.

Funding Code and Covenant Guidance

Following its release in November, we're now starting to see the initial stages of actuarial valuations subject to the new DB Funding Code (those with effective dates after 22 September 2024). There has been a somewhat tentative start to these, with the Regulator's Covenant Guidance – a key part of the funding and valuation process - only released in December.

We're expecting a far greater focus on assessing and monitoring employer covenant which will be required as part of actuarial valuations going forward. As a result, we've already engaged with a number of different covenant advisers to understand their views on what is required in the new Guidance. We are now in a position to hit the ground running when valuation dates come around, allowing all parties (including the employer and our co-trustees) time to appreciate the changes in requirements and understand what information will be needed, well in advance of valuation deadlines.

However, improved funding positions, with many schemes now being in surplus, have raised the question as to whether the new Funding Code and Covenant Guidance remain as relevant today as when they were first conceived a number of years ago! We'll no doubt be in a position to say much more once the first valuations on the new requirements are under our belts.

6 The year ahead – Summarising 2025 pension expectations

Although there may be many unexpected surprises ahead, we also know that several pension related initiatives are due to progress further this year.

January to March

The **Pensions Investment Review** call for evidence closed on 16 January. Several measures were proposed which are designed to accelerate consolidation and to move the focus from cost to value. These include a cap on the number of defaults which can be provided by a Master Trust or Group Personal Pension Provider, a minimum size for default funds, permitting non-consent transfers of contract based pensions, requiring employers to regularly review the value provided by their pension scheme and making the advice to employers on pension scheme selection an FCA regulated activity.

The HMRC consultation on how to administer **Inheritance Tax on Pensions** closed on 22 January. The response and a technical consultation on draft legislation will follow later this year, ahead of the 6 April 2027 implementation date.

While DWP are currently considering whether to use secondary legislation to resolve potential issues arising from **Virgin Media v NTL Trustees**, a further case is expected to be heard in February which could cover related issues. It could then be several months before the judgement is published.

By 15 February the Financial Reporting Council (FRC) will have published their response and finalised guidance following their consultation and annual review of **AS TM1**, the Statutory Guidance for Statutory Money Purchase Illustrations. Although this will be effective from 6 April 2025, FRC have proposed that no changes are made.

The FRC consultation on the **UK Stewardship Code** will close on 19 February with final rules expected in the first half of this year. The code applies to asset owners, such as pension schemes, and service providers who support asset owners in exercising their stewardship responsibilities.

The outcome of the **PPF Levy Consultation 2025/26** was expected in December 2024. This may result in a consultation on the legislation which currently restricts year on year levy increases to 25% and so prevents the levy being substantially reduced or removed. Any future reduction, or even removal, of the PPF levy will be welcomed by many solvent pension schemes.

Over the coming months we're expecting the government response to **Options for Defined Benefit Schemes: Open Consultation**. This proposed to make it easier for scheme trustees to extract scheme surpluses which can then be passed to employers and members. A surplus could only be extracted if member benefits are safe and surplus extraction will be conditional on how that surplus is used. We could also have further details on a **Public Sector Consolidator** as well as primary legislation providing for a new compulsory framework applicable to **Defined Benefit Superfunds** and other relevant consolidation models

Winter could also bring a legislative response to helping savers understand their pension choices: supporting individuals at the point of access. This would require trustees of occupational pension schemes to offer a decumulation service with products at an appropriate quality and price. Schemes would be required to devise a backstop decumulation solution, based on the general profile of their members. A member would be placed into this backstop solution if they access their pension assets without making an active choice.

The FRC consultation on **Technical Actuarial Standard 300: Pensions (TAS 300)** will close on 10 March with the response expected in Quarter 3, to be effective a month after publication. There are several proposed revisions relating to the new DB funding regime, including requiring those undertaking actuarial work on scheme funding to consider what prudence is appropriate given the material risk exposure of the pension scheme.

Spring

Trustees must submit their **Statement of Strategy** to TPR as soon as is reasonably practical once they've prepared or revised their Funding and Investing strategy. This is generally considered to be ten working days. For this year, TPR will not expect these to be submitted until the new digital service is live in the Spring. As TPR do not expect trustees to delay the valuation there could be a relatively short window during which recently completed Statements of Strategy should be submitted.

Also in Spring, the Information Commissioner's Office (ICO) will be updating their guidance on **Handling Cyber incidents**.

It's possible that Spring could also be when DWP propose amendments to **The Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021**. It is hoped that this will address some of the unintended consequences of removing, or modifying, the statutory transfer right when specified scam warning flags have been identified. The **Pension Scams Industry Group** (PSIG) is also due to bring forward proposals for PSIGs future direction in the first half of this year.

It wouldn't be Spring without a **Spring Statement** and a forecast from the Office for Budget Responsibility (OBR) and this is due on 26 March. The Chancellor has previously confirmed there will only be one major fiscal event a year, so this won't be a Budget Statement. However, pension related announcements are always possible.

APRIL TO JUNE

On 6 April HMRC's **Digitisation of Relief at Source (DigiRAS)** should be implemented, replacing the existing way in which Relief at Source pension schemes operate, with HMRC using individual level data to more accurately calculate member tax relief.

6 April is also the date from which HMRC will start making top-up payments to members of Occupational Pension schemes using Net Pay if member's total taxable income is below the personal allowance. This solution to the **Low Pay Anomaly** will apply to pension contributions paid in 2024/25 onwards.

Just over eight years after it was first announced in the March 2016 Budget, the first schemes will be connecting to the **Pensions Dashboard** by 30 April, starting with Master Trusts with over 20,000 members and FCA regulated pension schemes with over 5,000 members. When enough schemes have connected there should be a further DWP consultation on when pension scheme members will have access to Dashboards.

JULY TO DECEMBER…OR EARLIER.

The joint FCA/DWP/TPR consultation on the **Value for Money Framework** closed in October 2024 and a response is expected this year. This will then be followed by primary legislation, and then consultation on secondary legislation and FCA Rules. Trustees and IGCs of DC pensions will assess various metrics including investment performance, service and costs to determine a Value for Money RAG rating for their scheme. Pension arrangements rated as not Value for Money will be unable to accept business from new employers. Arrangements rated as not Value for Money and unable to achieve Value for Money within a reasonable time will need to consider transferring members to another arrangement.

We can also expect further details on Automatic Consolidation of defined contribution deferred small pension pots. The government intends that a central clearing house will be used to consolidate Automatic Enrolment pensions worth £1,000 or less which haven't received a contribution in the previous year. Employees could also be given the option to choose the pension scheme to which their employer contributes.

The **Extension of Automatic Enrolment** to those aged 18 and the removal, or lowering, of the lower limit of the qualifying earnings band has long been promised for the mid 2020's. A consultation on how this could be phased in is possible.

Last, but certainly not least, we are due a **Pension Schemes Bill**. This should include several of the above initiatives as well as ensuring that The Pensions Ombudsman decisions on overpayment are enforceable without a court order, and allowing the Pension Protection Fund (PPF) and Financial Assistance Scheme to make terminal illness payments to those with a life expectancy of twelve months, instead of only up to six months.

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