OPDU

Report 32

The Pensions Insurance Specialist

Protecting Trustees, the Scheme, Members & the Sponsoring Employer

OPDU IS MANAGED BY **THOMAS MILLER**

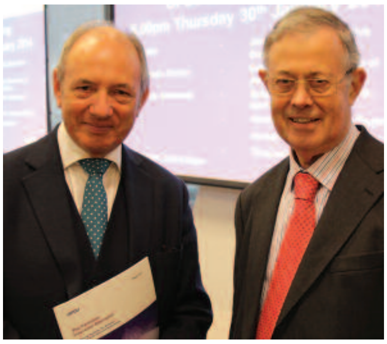
Contents Report 32

OPDU

News

A journey to better retirement outcomes

OPDU's Annual Meeting 30 January 2014



Retirement Planning is often referred to as a journey, where it is important to know your objective, how you are going to get there and be able to adapt to changing circumstances.

For Ronnie Bowie, First Past President of the Institute and Faculty of Actuaries, his objective was to address OPDU's Annual Meeting in London at 5pm on 30th January. Unfortunately, the Glasgow to Euston "Express" had other ideas. Calling on all his actuarial skills, he forecasted correctly that he would arrive at 6pm and suggested Ruston Smith, Chairman of the National Association of Pension Funds, might like to speak first.

Arriving just as the clock struck six and as Ruston finished his address, Ronnie told the audience that his journey in the lift from the 2nd to the 32nd floor of Reed Smith's offices was the fastest he had travelled all day!

Ronnie set out five steps to sustainable pension provision and how trustees could use their influence in helping improve member outcomes. Whilst the Government, Regulators, Employers and Trustees were much improved or improving, the Providers, with some notable exceptions, had, in his view, been disappointing. He suggested three changes: an extra 0.5% pa return without a lot more risk (including pressure on charges); increasing member contributions by 1% a year between the ages of 40 and 45 and targeting retirement income at State Pension Age rather than

"excellent meeting"

"high quality & interesting"

"excellent speakers"

"very good indeed"

"superb venue"

age 65. If these changes were made, modelling work undertaken indicated there would be a big difference in improving member outcomes and in the numbers achieving the Pension Commission target income replacement rates.

Earlier, Ruston Smith had looked ahead to the trends, challenges and opportunities in 2014, drawing upon a recent NAPF survey of 890 pension funds covering 6.8 million members. For defined benefit schemes, the rate of closure was stabilising and diversification of the underlying investments continued.

Diversification of investments was also a theme for defined contribution schemes but there was further work to do to help members understand their options and to get better value when taking their benefits. Ruston believed that opportunities would arise from increasing confidence in the economy and improving confidence in pensions, partly as a result of many more employers enrolling automatically their employees into pension schemes. The challenge for the industry was to build further confidence, with more people saving for retirement.

Jonathan Bull, OPDU's Chief Executive, had opened the Meeting welcoming the audience of over 100 delegates with several eminent people from the pension's community including the Chairman of the Pensions Regulator. Peter Murray, Chairman of OPDU's Advisory Council, then summarised the work that OPDU had undertaken in the last twelve months highlighting the wide range of circumstances which had given rise to notifications and claims.

He confirmed that OPDU continues to provide the most comprehensive cover and support, with the provision of lifetime cover for retired trustees proving popular. OPDU's membership continued to grow and there were now over 800 schemes holding assets valued in the region of £210 billion.

There was an extensive question and answer session, followed by a reception, with Reed Smith's offices offering a panoramic view of London's ever changing skyline.

Annual Pension Risk Conference

The OPDU Annual Pension Risk Conference was held at CBI Centrepoint on March 20th 2014. The theme of the conference was **"Key risks and practical solutions in a changing pensions world"**. The reference to "a changing pensions world" turned out to be remarkably appropriate as, on the day before the conference, the Chancellor announced sweeping changes to the DC pension provision in the UK in his Budget speech. We were able to modify the conference program to enable an extensive discussion of the implic-ations for DC pension schemes and their trustees once these changes take place.

The conference program commenced with the keynote address on "The Current Economic Climate and Investment Risk" given by Sharon Bell, Vice President in the European Portfolio Strategy Team at Goldman Sachs. This was a wide ranging review of the economic backdrop and its implications, particularly for the different equity markets around the world. Sharon was followed by Matthew Demwell, Partner in the Financial Strategy Group at Mercer, who examined "The Pension Regulator's Draft Code of Practice on Scheme Funding " and the issues which it raised for trustees and sponsors, including the need for integrated risk management.

Paul McGlone and Tony Baily, Partners at AON Hewitt, then examined "Investment Risk in DB Schemes" and the options available to trustees and sponsors for managing that risk. Tim Banks, Managing Director Pensions Strategies Group at Alliance Bernstein looked at "How to improve DC outcomes". Based on briefing documents issued by consultants at legal firms overnight, I then summarised the new proposals for DC schemes outlined in the Chancellor's speech and an extensive discussion on the implications of these for members and trustees then took place between the panel and the audience.

Following lunch, Robert West, Head of Pensions at Baker McKenzie talked about "Practical Legal Risks – a review of claims and how to avoid them". Robert was followed by Andrew Warwick-Thompson, Executive Director, DC Governance and Administration at The Pensions Regulator who examined the key areas on which The Pensions Regulator was focussing in 2014, including the issue of "pensions liberation". Finally, Paul Trickett, Advisory Board Chairman, Muse Advisory talked about "A practical Approach to the New Regime". An extensive discussion between the panel and the audience then took place touching not only on the governance issues raised in the presentations, but also the implications of the new DC regime.

As I write this, further details are emerging from the Government about the new DC regime and it is clear that this will have profound implications not just for DC members and trustees but, in all probability, funded DB schemes also. Clearly this is likely to be one of the topics covered at the 2015 OPDU Pension Risk Conference which will be held at a new venue given that the CBI Centrepoint conference centre has now closed. The next OPDU Annual Pension Risk Conference will be on 3 March at our new venue, 8 Eastcheap, Monument EC2A 2RS, and I recommend that you attend. **Peter Murray**

"It's a great credit to OPDU that it attracts such high calibre speakers"

"Excellent speakers"… "A quality event"… "A fascinating discussion"

News

OPDU Advisory Council

Changing of the guard


Peter Murray

Peter Murray has announced his retirement as Chairman of OPDU's Advisory Council and Terry Faulkner has been elected as his successor. The Advisory Council and Managers express their gratitude to Peter Murray for his invaluable contribution to OPDU's continued success.


Terry Faulkner

OPDU is delighted that Terry Faulkner has accepted the post and his wealth of experience and standing in the pensions' community will play a major role in ensuring that OPDU continues to lead the market in protecting trustees, pension schemes and sponsoring employers with its unique combination of comprehensive insurance and advisory services. Until his recent retirement, Terry was Group Head of Pensions at Rexam plc, a long standing OPDU member and he was also Chairman of the NAPF from 2003-2005.

OPDU Advisory Council: The Advisory Council is elected from the OPDU membership to represent the interests of the insured schemes and sponsoring employers to ensure that OPDU is as pro-active as possible in meeting the needs of its membership and in helping to raise standards in the management of pension schemes generally.

Terry Faulkner

Terry Faulkner retired as Rexam plc's Group Head of Pensions at the end of June 2014. His career in occupational pensions spans a number of senior pensions' appointments before joining Rexam and he has served as a trustee/fiduciary on a number of UK and International pension plan boards and Investment Committees. Terry was Chairman of the National Association of Pensions Funds (NAPF) from May 2003 to May 2005 and is a Fellow of the Pensions Management Institute.

Retirement

In 2008, when Jonathan Bull asked me whether I would be interested in becoming the Chairman of OPDU's Advisory Council, I was most interested. As well as the Council, the position involves chairing the Annual Meeting and the Annual Pensions Risk Conference and representing OPDU at conferences such as the NAPF Investment Conference and Annual Conference.

As the name implies, the Advisory Council monitors changes in the risks to which trustees, schemes and sponsors are exposed and advises OPDU so that the OPDU policies can be updated to cover these risks. There have been significant developments in the risks to which trustees are exposed during the last 6 years, for example, while administration errors remain the largest single area of claims, during recent years the proportion of these relating to DC schemes rather than DB schemes has increased sharply. Also there have been significant increases in claims arising from areas such as investment, member communication and deficient execution of changes to Trust Deeds and Rules. Members of the Advisory Council are very experienced and are drawn from all over the industry and their advice is invaluable to OPDU in improving its policies.

Having reached 72, I have decided to retire from all my trustee and investment adviser positions and, in view of that, to retire also from OPDU. I am delighted to tell you that Terry Faulkner has agreed to become my successor. As a former NAPF Chairman, Terry will be well known to most of you and, with his experience and expertise, is ideally placed to take things forward. I wish him every success. Finally, I would like to thank my colleagues on the Council for their support over the years and also to thank Jonathan Bull and the OPDU team. I wish them well for the future. **Peter Murray**

Advisory Council

Terry Faulkner
Chairman

Yally Avrahampour
Consultant

Steve Balmont
The Association of Corporate Trustees

Phil Casson
AstraZeneca UK Limited

Julie Cook
BAE SYSTEMS plc

Dermot Courtier
Kingfisher plc

Frank Curtiss
RPMI Railpen Investments

Robin Ellison
Pinsent Masons LLP

John Greenfield
NOW: Pensions

Richard Thornton
Milk Pension Fund Trustees

Some key issues for Trustees

Here is our latest update on some of the issues that are currently receiving attention by trustees

Pension Schemes Bill (1)

The changes announced originally in the Budget certainly give plenty of food for thought. Have the key changes been communicated to members and are procedures in place to communicate clearly with those who may be considering taking their benefits prior to April 2015? What further communications are required for those within ten years or so of their Selected Pension Date, and further ahead, all members of the Scheme? How can engagement be harnessed effectively?

Pension Schemes Bill (2)

What will the guidance guarantee actually mean in practice? How will this dovetail with the existing support provided to members taking their benefits and what will actually be expected from the trustees?

Pension Schemes Bill (3)

To what extent does the scheme need re-designing? What are the employer's views? How should the default fund be reconfigured and how do we best understand how members may take their benefits? Are target date funds preferable? What other investment funds should be offered, particularly in the period before benefits begin to be taken? Will the trustees offer drawdown within the Scheme or simply facilitate a transfer to another arrangement? What support should be offered to those members who opt for the uncrystallised funds pension lump sum and how will this be regulated?

Pension Schemes Bill (4)

Is there a structure in place that will allow swift decision making? What implications will there be for Defined Benefit Schemes now that it is known that transfer values are to be permitted and how should this be factored into cash flow, investment and de-risking considerations?

Pensions Act 2014 - Charges (1)

Do the Defined Contribution Scheme charges comply with the revised requirements from April 2015? Are there any issues to address relating to active member discounts, commission, or consultancy charges which will be banned in qualifying workplace pension schemes from April 2016?

Pensions Act 2014 - Charges (2)

What form will the legal duty to disclose transaction charges take from April 2015 and will transaction charges be included in the overall charge cap when it is reviewed in 2017? What level might the cap be and to what extent is there political consensus?

Automatic enrolment

With larger employers having staged, trustees of these Schemes will want to ensure that all scheme documentation and communication material, including deeds, booklets and websites is up-to-date. Those employers who staged first will be considering their re-enrolment requirements. For those employers who have yet to stage, the trustees' focus should also be on ensuring that documentation is being brought up-to-date and that the Scheme is well placed to cater for the needs of its new members.

31 DC quality features

Trustees should have undertaken a review of compliance with the 31 DC quality features outlined in the Code of Practice No.13, preferably utilising the template provided by the Pensions Regulator. Compliance with the Code is not mandatory but trustees should be able to explain how their approach complies with the Code or if not, be able to justify any departure from the Code. Occupational pension scheme trustees will need to provide an independently audited statement that they have met the new governance requirements.

Diary Dates 2015

Annual Meeting:
Wednesday 28 January
17.00 - 20.00
Venue: Reed Smith LLP
The Broadgate Tower
Primrose Street EC2A 2RS

Annual Pension
Risk Conference
Tuesday 3 March
09.30 - 16.00
"Managing Changing and Emerging Pension Scheme Risks"
Venue: 8 Eastcheap
EC3M 1AE

In accordance with OPDU's aims of helping to raise standards of pension management and administration, both events are free to attend and please register your interest at:

enquiries@opdu.com

There will be an announcement shortly with the full programme and speakers.

Membership Tips

Contact details: please advise of any changes in contact details including personnel and office moves as soon as possible.

Trustee appointments: similarly, it is important we maintain accurate records of current or former trustees. This will ensure they receive their membership User Cards and Handbooks which are part of the benefits of OPDU and that retired trustees have the benefit of lifetime cover. This applies also to named company pension personnel who have the same benefits of cover.

Claim notifications: please notify any circumstances that may give rise to a claim us as soon as possible. We would also encourage the use of the OPDU Advisory Service which provides general guidance and advice on matters affecting the day-to-day administration of the pension scheme. Matters that are discussed with the Advisory Service will deem to have been notified if they subsequently materialise as claims which, in practice, can be sometime later.

News

Pot follows member

Following the Pensions Act 2014 receiving Royal Assent, there is the power to introduce regulations to provide for an individual's DC pension fund to be automatically transferred into a new employer's pension arrangement when they change jobs. This is only likely to apply to funds of up to £10,000 and is expected to be introduced in 2015.

DC communication

The DWP has amended regulations on member communications. The changes include a requirement for trustees to tell members about their open market option at least four months before their Selected Pension Date and if they are invested in a lifestyle profile, that members are notified of this on at least two occasions. Other changes include the greater potential use of email and websites and more flexibility to tailor Statutory Money Purchase Illustrations.

Short service refunds

Where an individual is entitled to money purchase benefits only, the Pensions Act 2014 provides for their rights to vest after 30 days' qualifying service. Once in force, which is expected to be some time in 2014, it will mean that money purchase plans and money purchase sections of hybrid plans will no longer be able to pay short service refunds where an individual has been in the Scheme for 30 days or more.

European Pensions Directive

The update to the Institutions for Occupational Retirement Provisions directive, which will come into effect in 2017, has revisions including a requirement to continually evaluate environmental risk, introduce new governance requirements for schemes, encourage investment in long term assets and require cross-border schemes to be fully funded. Some industry commentators have described the revisions as too prescriptive and potentially adding increased costs. There is also a stipulation that trustees should be "fit and proper" and have professional qualifications. However, recent comments from Saskia van Ewijk from the Insurance and Occupational Pensions Unit state that the intention is not to "outlaw trustees" and that the Commission "understands the role the trustees play in the UK system". It is possible there will be a Pensions Act 2016 in the UK to implement the changes into UK law. Trustees will need to keep appraised of developments.

Regulator's new statutory objective/ DB Funding Code of Practice

The new statutory objective for the Pensions Regulator requiring it "to minimise the impact on the sustainable growth of (a scheme's) employer(s)" in the exercise of its scheme funding functions is now in force. The revised Code sets out the Regulator's expectations for the trustees to have regard to an employer's business plans and to make use of the flexibilities within the scheme funding regime when agreeing funding arrangements for their scheme with the sponsor(s). Trustees need to take this into account now when considering scheme funding issues.

End of DB contracting-out

The introduction of the new single tier state pension will lead to the abolition of contracting-out for defined benefit pension plans. Trustees of schemes that are affected will need to consider proposals from the sponsoring employer and ensure any changes are planned and implemented appropriately.

Single tier state pension

The new single tier state pension will apply to individuals who reach state pension age on or after 6 April 2016. The pension will be no less than £148.40 a week and individuals will qualify for the full state pension once they have reached state pension age and have accrued 35 qualifying years. The minimum number of qualifying years for a partial state pension will be set out in the regulations. State pension age is to increase from 66 to 67 for men and women between 6 April 2026 and 5 April 2028. In the future, the Secretary of State will be required to review state pension age at least once every 6 years and lay a report before Parliament stating whether or not there should be any change. The first report is due by 7 May 2017. A key factor will be whether, on average, a person who reaches state pension age within a specified period can be expected to spend a specified proportion (expected to be no more than one-third) of their adult life in retirement.

PPF Levy

Experian has replaced Dun & Bradstreet as the insolvency risk provider. The development work for calculating insolvency risk took longer than anticipated but the details are now available and trustees and employers should be considering the implications for their levy and what action can be taken to reduce the levy for 2015/16, so far as they are able. In addition, the Pensions Act 2014 provides for an increase in the current compensation cap for anyone with 21 or more full years' pensionable service, up to a maximum of twice the current compensation cap.

Pension Administration Standards Association (PASA)

In May, PASA published a draft consultation on "Guidance for Pension Administrators on Recording and Reporting Errors". The intention is to set out a common definition of errors and a common way of reporting errors. It is also exploring producing an industry benchmark with an average error rating, so that trustees can measure themselves against an industry standard.

Pensions Liberation

How will this be affected by the recent Budget proposals and is there any sign that recent HMRC and other regulatory action is making a difference? The Pensions Advisory Service has expressed concern after having received almost 1,000 calls in the last 12 months and suggests there is evidence that specific schemes or people who have just lost their jobs are being targeted. Meanwhile, HMRC has introduced new legislation relating to the fit and proper status of scheme administrators, requiring all scheme administrators of registered pension schemes to be a fit and proper person.

Following the Budget announcements, this is not quite the period of reflection and stability some had hoped for, with plenty of issues to be considered and action taken ahead of April 2015 and in some cases April 2016.

News from the Pensions Archive

Stephen John Pegg

The directors of the Pensions Archive Trust (PAT) record with very much regret the death of Stephen Pegg on 16 May 2014 at the age of 68. Stephen had joined the board of PAT in March 2009 following his retirement in June 2008 after over 35 years in pensions management. Stephen had been Corporate Pensions Director of The BOC Group plc, a long-term insured member of OPDU.

Board appointment

The Board of PAT was very pleased to welcome David Robertson as a director during the year.

David since 1992 has been the head of the Permanent Secretariat at the Association of Consulting Actuaries (ACA) and has acted as the joint external secretary to the All-Party Parliamentary Group on Pensions. He has also served as a member of two pension trustee boards for over 25 years.

David Robertson is a graduate in politics from the London School of Economics. His early career was as a specialist in industrial relations, where he worked for the Local Authorities' National Employers, the Engineering Employers London Association and then subsidiaries of De La Rue and John Brown plc, where he was a Personnel Director. He moved into a public relations and public affairs role in the mid-1980s and has been a director of the specialist financial services consultancy, Underline Group, since then to date.

Interns

PAT has been pleased to participate in the LMA's intern scheme over the last year which assists young people develop careers in Archive Administration.

Sarah Thiel completed in August her year's internship with LMA/PAT and will now be taking up the place she has been offered at University College London to study Archive Administration. She had recently added to the website a section on Retail Sector Pensions to PAT's Directory of Archives holding pensions material, following a survey she had organized across a number of company archives in the retail sector. The Boots collection covers pensions material over one hundred years, 1911 – 2011, Sainsbury covers the 1920s -1990s and Mark & Spencer the 1930s – 1990s. We wish her well for the future.

We welcome her successor Joe Williams who will be working with LMA/PAT for the next 12 months. Joe has had some interesting assignments since graduating from University College London, with BA (Hons) in Ancient World Studies and a Masters in Cultural Heritage.

On graduating from his MA, he completed a 6 month project for UNESCO in Mozambique, at the World Heritage Site of Mozambique Island. He assisted with cataloguing and photographing museum collections, staff training, exhibitions and museum accessions.

On return from Mozambique he completed a postgraduate diploma in Heritage Management, focusing on heritage marketing, interpretation and conservation. This was undertaken at the Ironbridge Institute, University of Birmingham.

Since graduating from Ironbridge Institute he has worked as a cataloguer for the Transport Trust; in visitor services for the Sussex Archaeological Society at Lewes Castle, as a volunteer for the East Sussex Record Office at The Keep outside Brighton, and as a researcher and assistant for the Royal Anthropological Institute (digitising an extensive collection of glass plate negatives taken in early C20th Nigeria).

His main project for PAT will be cataloguing the second part of the George Ross Goobey collection which consists of 44 boxes of papers which he hopes to complete during his internship. This will facilitate the integration with the first part which has already been catalogued.

Friends of PAT

PAT was invited by the organisers of the Pensions and Benefits Show to have a display area at the Show in May to illustrate the work of PAT in recording the history and development of occupational pension provision in the UK. We were very grateful for this opportunity. We want to encourage those who work in pensions to regard the Pensions Archive very much as their archive which records the part they and their predecessors have played in developing pension provision in the UK.

Subscriptions or donations from individuals who wish to support the Trust's work by becoming a Friend of PAT are very welcome. The Trust can claim Gift Aid on donations from individuals who pay Income Tax and/or Capital Gains Tax in the UK. For queries about Friends of PAT, contact Malcolm Deering:
malcolm.deering@ btinternet.com

For all other questions about PAT, contact Alan Herbert:
alanherbert@ btconnect.com

Newsletter

PAT produces a quarterly newsletter which gives updates on the Trust's work and collections; to receive future copies please e-mail me at the address below.

Alan Herbert
Chairman, The Pensions Archive Trust
01438 869198
alanherbert@btconnect.com

Q&A's on pension trustee liability

Why do we need insurance when we have an indemnity and an exoneration clause to protect us against claims?

An indemnity may be given by the scheme or the sponsoring employer company and many trustees will have the benefit of exoneration clauses within the trust deed and rules excluding them from liability. However, it is not always appreciated that such clauses are subject to statutory limits. For example, an exoneration or indemnity from the fund cannot operate for any breach of trust relating to investments and it is also prohibited for the scheme to indemnify trustees for civil fines and penalties. It should also be appreciated that an indemnity from the employer would be of no value upon an insolvency when the trustees are still having to manage the scheme.

Exoneration clauses are also subject to several other limitations including not affording protection from claims involving third parties and moreover, they will always be construed restrictively by the courts. In addition, the problem with relying purely on exoneration and indemnity provisions is that they merely transfer any liability between the trustees, the beneficiaries and the employer. Pension trustee liability insurance, however, will normally provide cover for the trustees, pension scheme and sponsoring employer.

Insurance provides an external source of protection and should stand in front of such indemnity and exoneration clauses. In today's environment, trustees do not usually wish to "hide" behind exoneration clauses when facing valid claims from pension scheme members.

We have been told that we do not need trustee liability insurance as we are covered under the company's Directors & Officers policy, is that correct?

The answer depends on the poIicy wording and terms of cover. However, Directors & Officers (D&O) policies will often contain an exclusion for any acts or omissions while acting as a trustee or administrator of the pension scheme. Generally, it is not recommended that reliance be placed upon a D&O policy of insurance as the cover will not be tailored to meet the specialised circumstances relating to pensions and potentially there will be competing calls on the policy which are outside the control of the trustees.

Are we covered for past actions that were taken before the date that we take out insurance?

Trustee liability insurance operates on a "claims made" basis which means that there is potentially cover for claims made against the insured during the policy period irrespective of when the event giving rise to the claim occurred. Therefore, this is another reason to consider taking out insurance sooner rather than later to give protection for mistakes that might have already occurred in the past. However, this will be usually subject to not previously having had insurance and being unaware of the circumstance likely to give rise to the claim when purchasing insurance.

What is the position when a trustee retires – are they still covered?

A trustee's personal exposure does not cease when they retire and their post retirement situation may make them particularly vulnerable. Problems in pensions often take a considerable time after the event to materialise. It is important, therefore, to check that the position of retired trustees and pension managers is properly protected. The solution is for retired trustees to have the guarantee of cover in the event that the scheme ceases to be insured. They can then rest assured that they have cover personal to them, irrespective of what the employer or trustees have done, or not done, about insurance since they retired. It is again important to check the extent of cover provided in this respect as policies do vary (the OPDU Elite Policy provides lifetime cover for retired trustees and named pension personnel from the date of expiry of the main policy of insurance thus giving valuable peace of mind).

However, if the main policy of insurance is renewed each year then the cover for retired trustees should remain in place.

Have claims been made against trustees?

OPDU's own claims experience has seen issues which have involved individual claims sums of up to £20m to date. One common feature is, as one would anticipate, the importance of the accuracy of data and we encourage trustees therefore to ensure that regular data healthchecks are undertaken. Other issues which have given rise to problems and potential liabilities include: incorrect formulas used for calculating benefits; interpretation of Trust Deeds; overpayment of benefits; misapplication of Scheme Rules; seeking court directions; early retirement & ill-health disputes; rectification proceedings, accounting irregularities; DC choices of investment funds; Pension Sharing Orders; general administration errors; TUPE issues; misrepresentations by trustees; transfer values; incorrect quotations; discrepancies between scheme documentation and administration practice; delays in transfer and payments of benefit assets; and PPF levy issues.

Some recent claims paid

Claim 1

Two Scheme members received unauthorised benefits in that they received a cash sum of 25% of their total benefits rather than 25% of their Lifetime Allowance. The Scheme members could not return the overpayment as they had arranged their affairs accordingly. As a consequence HMRC levied penalty charges of £140k which were covered under the policy.

Claim 2

The Insured failed to ensure pension benefits were invested when Scheme members opted to transfer their benefits from one scheme to another. The members completed the necessary documentation which was received by the Insured. All of the Scheme members requested that their accrued benefits be invested in a variety of equity funds.

Unfortunately the Insured overlooked the documentation and the funds languished in a cash account and failed to benefit from large equity gains over the given period. The Insured’s maladministration resulted in losses exceeding £450k.

Claim 3

The Insured was subject to an investigation by the Pensions Regulator and potentially faced the prospect of a Financial Support Direction or a Contribution Notice. This matter perfectly illustrates the need for cover given the very high investigatory costs.

Claim 4

This information is in the public domain. The Insured received a Pension Protection Fund levy invoice for the period 2010/11 which calculated the levy to be £175k. The levy is calculated in two parts namely, the Scheme based levy and the Risk based levy. The Risk based levy is calculated by use of failure scores applied by ratings agencies when calculating the solvency of an employer: the higher the risk of insolvency, the higher the Risk based levy.

From 2007 to 2010, the Insured's Risk based levy was nil based on the strength of the principal employer. However, when the PPF calculated the 2010/11 levy, the ratings agency, did not take account of the financial statements that had been filed at Luxembourg’s companies’ registry. D&B had expected to be provided with the financial statements rather than having to chase them down. As a consequence the ratings agency did not take account of the strength of the principal employer hence the enormous increase in levy from c. £6k to c. £175k.

The Insured appealed to the PPF Ombudsman which found in the Insured’s favour and directed the PPF to recalculate the levy. The Insured was also awarded costs. However, the PPF appealed to the High Court essentially citing that the PPF had followed the rules on which the levy is calculated and it was unreasonable for the PPF Ombudsman to have interfered with the decision. In a very technical judgement handed down on 23 January 2014, HHJ Spink QC found in favour of the PPF and concluded that the PPF Ombudsman made an error of law in its reconsideration of the PPF’s decision.

The Insured benefited from the policy for cover for costs and the balance of the levy over and above what it originally expected to pay.

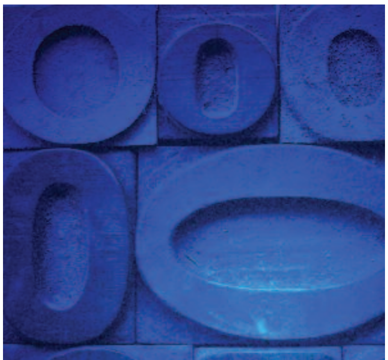
Claim 5

The Insured took out cover predominantly to guard against the risk of claims by missing beneficiaries. Despite efforts to find the beneficiaries, including advertising, several hundred members of a particular scheme could not be traced. Whilst individual Scheme members have accrued modest benefits the combined value exceeds £1.5m.

In recent weeks two Scheme members have come forward to claim their benefits. It remains to be seen whether others follow.

Claim 6

TThe Insured were contacted by a person claiming to be the Scheme member. After satisfying the security criteria over the phone, the Insured were satisfied that they were speaking to the member who had requested that his pension entitlement be released early. The Insured sent the member the appropriate forms which were returned duly completed and the funds were released. It transpired that the funds were released to a crook who was subjecting the member to mental and physical intimidation. The alleged perpetrator had access to the member's property and papers because he had initially presented himself to the member as a foreign attorney. The matter is under criminal investigation but final losses are likely to total approximately £30k.



Insurance protection: a brief guide

Liability for breach of trust is a personal liability and a trustee is liable to both the scheme beneficiaries and to scheme creditors. Professional advice should be sought when appropriate and failure to do so may in itself be held to be a breach of trust. If trustees are uncertain as to how to exercise their powers, they can also apply to the court for directions. The risk is potentially greater after a winding up where there may be missing beneficiaries or other contingent liabilities and no assets. A trustee or trustee director is also potentially at risk of having to pay a civil fine for breach of pensions' legislation. Fines for individuals range up to £5,000 and for corporate trustees £50,000.

Insurance Protection

In these circumstances, insurance is playing an increasingly important role in protecting trustees and pension scheme assets. It provides an external resource of protection and should stand in front of such indemnity and exoneration clauses. The purchase of a properly drafted and comprehensive insurance policy can be a cost-effective means of protecting members benefits, individual trustees, the sponsoring employer, pension managers and internal administrators from losses resulting from claims, be they well-founded or not.

If the decision is taken to adopt insurance, however, it is important to have a policy specifically designed to respond to the needs of trustees and other individuals involved in the management of pensions. This is highlighted by the potential conflicts of interest which commonly exist when a trustee is also a director of the sponsoring employer company with duties to the company and its shareholders. As a trustee, however, there is an overriding duty owed to the scheme beneficiaries which is paramount. Accordingly, as noted above,it is not recommended that reliance be placed upon a Directors & Officers (D&O) policy of insurance as the cover will not be tailored to meet the specialised circumstances relating to pensions and potentially there will be competing calls on the policy.

Retired trustees

A trustee's personal exposure does not cease when they retire and their post retirement situation may make them particularly vulnerable. The solution is for retired trustees to have the guarantee of cover in the event that the scheme ceases to be insured. They can then rest assured that they have cover personal to them, irrespective of what the employer or trustees have done, or not done, about insurance since they retired. It is again important to check the extent of cover provided in this respect as policies do vary (OPDU Elite Policy provides lifetime cover for retired trustees at the date of expiry of the main policy of insurance thus giving valuable peace of mind).

What should be covered?

Below is a guide to the main headings of cover which can be included:

Guide to main headings of Insurance Cover

Errors and omissions	*Prosecution costs*
Damages, judgements, settlements	*Employer Indemnities*
Regulatory civil fines and penalties	*Exonerated losses*
Ombudsman awards	*Litigation costs*
Defence costs	*Retirement cover – lifetime*
Full severability of cover	*Costs re investigations by regulatory authorities*
Individual representation	*Mediation & Arbitration*
Maladministration	*Court Application Costs*
Public relation expenses	*Third Party Provider Pursuit Costs*
Extradition proceedings/bail bond costs	*Emergency Costs*

Court Applications

Trustees and pension schemes can also incur significant legal expense in going to court to seek directions or if they are joined by another party who is seeking the court's directions. Insurance can be obtained to cover these expenses which do not necessarily involve a legal liability upon the trustees but the scheme will usually be responsible for the legal expenses of all the parties involved. There have been several high profile cases involving costs in excess of £1m which have had to be met from pension scheme funds. (OPDU Elite provides an extension to reimburse such costs – it is important to note that this type of legal expense would not usually fall within the scope of "defence costs" as defined in many insurance policies).

Claims

The value of insurance cover is probably best demonstrated when it comes to claims which can affect even the best managed schemes. Regrettably, there has been a recent substantial increase in claim notifications which demonstrates that errors can occur even in the best managed schemes particularly in the increasingly dominant environment of defined contribution schemes.

In particular we are seeing an increase in matters relating to investment issues. As noted above, it is not possible for a scheme's rules to excuse a trustee from personal liability in respect of the discharge of their investment duties. Importantly, investment issues for pension schemes have become much more complex and diverse. Classes of assets have widened and investment strategies have become more intricate with trustees making decisions relating to matters such as hedges, swaps and buy-ins. These factors have increased the potential for claims.

In addition, the conversion from defined benefit schemes to defined contribution schemes has also continued. This has generally meant potentially lower benefits under new schemes which has also given rise to closer scrutiny from members and trade unions with more issues arising for trustees to deal with as a result.

With this continued growth in defined contribution (DC) schemes, it is important to recognise that the trustees of such schemes face different legal risks and exposures from those of defined benefit schemes. DC trustees have ultimate responsibility for the accuracy of statements, market valuations and increasingly important, the selection and monitoring of investment vehicles offered. These factors increase the risk for claims occurring which has been borne out by claims experience

Wind up

Separate discontinuance and "run off" policies of insurance can be purchased to protect trustees once a scheme has wound up. Cover can be provided to protect trustees against loss for liability or defence costs arising from breaches of trust whilst the scheme was ongoing. Another relevant consideration is that there may be missing or overlooked beneficiaries who surface when all the assets of the scheme have been distributed. **(For further details see opposite page 13).**

Cost

The cost of trustee liability insurance will naturally vary according to the size of the scheme but it is also dependent on several other factors. However, the cost starts at a few thousand pounds for a small scheme and an approximate indication of cost should be able to be obtained easily for any size of scheme without having to complete a full application.

Conclusion

By taking out insurance, trustees can be confident that they have protection against the liabilities that might arise in performing their duties while also giving members comfort that their interests are being looked after properly in preserving the fund assets which is particularly important today when deficits are common.

Claims

Some typical examples of the subject matter of claims in which OPDU has been involved:

- **Incorrect formulas used for calculating benefits**
- **Interpretation of Trust Deeds**
- **Overpayment of Benefits**
- **Misapplication of Scheme Rules**
- **Seeking Court Directions**
- **Early retirement & ill-health disputes**
- **Rectification proceedings**
- **Accounting irregularities**
- **DC choices of investment funds**
- **Pension Sharing Orders**
- **General administration errors**
- **TUPE issues**
- **Misrepresentations by trustees**
- **Transfer Values**
- **Incorrect quotations**
- **Discrepancies between scheme documentation and administration practice**
- **Delays in the transfer and payment of benefit assets**
- **PPF levy issues**
- **Equalisation issues**
- **Scheme amendment issues**

The issues have involved individual claim sums ranging up to £20m.

Insurance for schemes winding up

With the regrettable increase in the number of schemes winding up, OPDU has a separate Discontinuance Policy of insurance to cover trustees for the liabilities that can still potentially arise following completion of the wind up.

Even if a scheme or company has totally discharged its future liabilities in relation to the pension scheme, a past trustee remains personally liable, potentially for their lifetime, for any acts they undertook whilst in the role. The following is a brief summary of the cover provided and please email enquiries@opdu.com for further information:

What is covered?

- OPDU Elite Discontinuance will pay the loss a past trustee or employee is legally obliged to pay as a result of a wrongful act in relation to the named pension scheme(s).
- It provides cover for wrongful acts committed prior to the inception of the policy, from the date the scheme was first established
- It will also pay all reasonable legal costs incurred in relation to an official or fact finding investigation by the Pensions Ombudsman, Pensions Regulator or other equivalent body.

Who is covered?

- Past trustees
- Employees
- A corporate trustee company
- Lawful spouses, estates, heirs or legal representatives of past trustees or employees in the event of death, incapacity, insolvency or bankruptcy
- Any other natural person or entity who acted as trustee as attached by specific written endorsement.

Who is included in the definition of trustee?

- Any natural person, including a director or officer of a corporate trustee company, who was appointed as a trustee.

Who is included in the definition of employee?

Any natural person who provided services in relation to the pension scheme whilst in the employment of the sponsoring employer company, corporate trustee company, trustee or pension scheme, including:

- Directors and officers
- Committee and / or board members
- Administrators
- Pension scheme managers.

What is included in the definition of corporate trustee company?

- Any company appointed to act as a trustee, regardless of whether that company was a subsidiary or not of the sponsoring employer company.

What constitutes a claim?

- A written demand alleging legal liability
- A civil or arbitral proceeding
- A criminal suit
- An administrative or regulatory proceeding
- An official investigation.

What wrongful acts are covered?

OPDU Elite Discontinuance offers protection against a comprehensive range of allegations, including:

- Breaches of trust, duty and statutory provision
- Negligence
- Administrative errors
- Wrongful omissions
- Misstatements
- Misleading statements
- Maladministration
- Financial loss resulting from damage, loss or destruction of pension scheme documents.

What is included in the definition of loss?

- Damages
- Judgments
- Settlements
- Awards (including distress awards or compensation as determined by the Pensions Ombudsman)
- Defence costs
- Costs for legal representation in relation to an official or fact finding investigation instigated during the policy period (i.e. where there is no requirement for an allegation of a wrongful act) by the Pensions Ombudsman, Pensions Regulator or other equivalent body.

What is included in defence costs?

- All reasonable third-party fees, costs and expenses that are incurred to defend or appeal a claim.
- Provision for full advancement of defence costs, where required.

Additional features of Elite Discontinuance

- Limits of liability to £10m and higher if required
- Small retention might be applicable
- Policy periods ranging from 1 year to 15 years are available
- Optional extensions are available to provide cover for:
  - Civil fines and penalties (where insurable and the premium is not being paid for out of the scheme assets); and
  - Member nominated trustees in the event of innocent non-disclosure or misrepresentation.

OPDU Elite Discontinuance is underwritten by ACE European Group Limited.

OPDU

The Pensions Insurance Specialist:

Protecting Trustees, the Scheme, Members & the Sponsoring Employer

OPDU protects pension schemes by providing a unique combination of risk management and comprehensive insurance cover to trustees, administrators and sponsoring employers. Pension schemes holding total combined assets in excess of £210bn have joined the membership which ranges from large schemes to small.

OPDU's insured members can readily purchase limits of cover between £1m and £50m or higher limits can be arranged if required. The cover has been developed for the special insurance needs of pension schemes but can be varied to meet the specific requirements of individual schemes.

OPDU affords a valuable external resource for reimbursing losses suffered by pension schemes. The asset protection thereby given is ultimately of benefit to pension scheme members.

OPDU is managed by Thomas Miller, the world's leading independent manager of mutual insurance companies. **OPDU Elite** is underwritten by ACE European Group Limited. The ACE Group of Companies is a global leader in insurance and reinsurance.

Court Application Costs cover is available to give increased protection to pension scheme assets. The cover is able to pay the legal costs and expenses incurred by trustees or ordered to be paid out of the pension scheme in seeking a declaration or directions from the court.

OPDU Elite cover to:

- Trustees
- Corporate trustees
- Directors of corporate trustees
- Sponsoring employers
- The pension scheme
- Internal administrators
- Internal advisers
- Internal dispute managers

OPDU Elite cover for:

- Ombudsman complaints
- Defence costs
- Employer indemnities
- Exonerated losses
- Litigation costs
- Investigatory costs
- Data risks
- Mitigation of potential claims
- Prosecution costs
- Errors and omissions
- TPR civil fines & penalties
- Minimising risk to reputation
- Extradition proceedings
- Retirement cover - lifetime
- Third party service provider pursuit costs
- Court Application Costs

- Discontinuance insurance for schemes in wind-up

Advisory Service:

- Problem solving
- Guidance on minimising liabilities
- Personal representation
- Working with your own advisers

Data – be diligent or face the dangers

Louise Howard Senior Counsel, Taylor Wessing

Did you and your advisors get your scheme data in order by the end of 2012? Was that the end of the story or the beginning? The Pensions Regulator put record keeping on its "to do" list in 2012 thrusting it for the first time onto trustee agendas. But things appear to have stalled a bit in 2013. Whether the Regulator is or is not making record keeping a priority at present is really just the tip of the iceberg, so here we take a step back and look at all the obligations trustees face in relation to the data and records they hold, what happens when things go wrong, and finally what to expect next.

The Regulator steps in …

Trustees, administrators and other pension professionals would all agree that having the right information is fundamental to the smooth running of a pension scheme, whether it be DB or DC. Yet, alarmingly, errors and misinformation remained very prevalent in the first decade of this century. In 2010, the Pensions Regulator decided enough was enough and rolled its sleeves up to clean up the mess. It set stringent targets for schemes to ensure that their basic data was accurate and up to date. Schemes were asked to achieve 100% accuracy for "common data" (eg: name, address and date of birth) for records created after May 2010 and, the not much lower target of 95% for records created before that. When one considers that some schemes have been operating for well over half a century, that's a lot of records to tidy up. The Regulator's view was that poor record keeping can lead to significant additional costs in a number of areas such as administration, error correction, claims from members, buy-outs, wind-ups and may even necessitate the making of more conservative actuarial assumptions.

So what are trustees and their administrators supposed to be doing? Well, the three types of data common, conditional and numerical are treated differently. Common data is the most basic pieces of information such as name and address. Whilst this basic information may not assist with calculating any pension entitlement, absence of correct data could mean a person is not identified or traced, which would clearly be a major problem in providing scheme benefits.

Conditional data is the "crunch" data – the vital information that means the scheme can run. It is not possible to be overly prescriptive at a general level about what will or will not count as this data as it will be conditional upon many things such as the type of scheme, scheme design, a member's status and also events that may occur during the life of the scheme, hence the name.

Finally numerical data, which is further information that may help put common and conditional data into context. Examples include pensioner type (member, spouse/civil partner, child), membership status across the scheme or perhaps data such as how many members have lifestyle investment strategies or AVC records or perhaps records of part-time workers.

The Regulator's reports have indicated that the response to the common data "cleanse" was very positive with high levels of achievement. The picture is less rosy with conditional data. Only one fifth of pension scheme members were in schemes having a conditional data score over 90%. When considered against the responses received in 2012 that nearly 90% of schemes intended to score their conditional data by the end of that year, it is clear that that's pretty poor in terms of action.

This stalling was addressed in December when the Regulator issued an update on record keeping. The update indicated it was concerned about stalling and planned to review its guidance this year. The message was clear that the Regulator does not expect schemes to only take action when targets were set and highlighted that trustees have a duty to maintain adequate records.

Enforce what? …

If the Regulator steps up its interest in conditional data sprucing, we may see the return of the forceful messages about compliance that we saw in 2011 and 2012 again. But how scared do trustees need to be? There are no express sanctions that the Regulator can issue as regards poor record-keeping. Where the Regulator has "teeth" is in being able to enforce the requirements of pensions legislation. In the past, the Regulator has chosen to particularly highlight s.249A of the Pensions Act 2004 which makes it a requirement for trustees to establish and operate specific internal controls, adequate for securing compliance within the rules of the scheme and legal requirements. If the Regulator makes moves to any enforcement action, indications so far are that this will be the most likely statutory provision invoked.

Why it is so important to get it right?

Nothing is new here, the Regulator has just been tackling a problem that has been around for years; poor records and errors lead to mistakes. The impact of a mistake can be hugely inconvenient and costly for schemes, trustees and service providers.

One of the most common mistakes that flows from incorrect member data is overstatement or overpayment of benefits. The legal position is that trustees of a scheme are required to provide benefits in accordance with the scheme rules. As the Pensions Regulator acknowledges, they do not have power to pay benefits higher than specified in the scheme rules. The fact that someone has received misleading or incorrect information does not, on its own, confer a right to benefits at the incorrectly quoted level.

When a problem is discovered, trustees find themselves having to seek recovery of the overpayment to correct the historical position and also assure the position is corrected for the future. There are obviously costs and inconvenience associated with this, but things can be further complicated.

Members have the ability to challenge the trustees if they can legally establish that it would be unfair for them to have to pay the money back. If there has been some irreversible action (or spending) by the member in reliance on the information (or payment) which turned out to be incorrect, then it might be possible for them to retain what they were not technically entitled to, in turn causing loss to the scheme.

Furthermore, incorrect benefit quotations are almost always viewed as maladministration by the Pensions Ombudsman who can award compensation which will attempt to put the member in the position they would have been if the correct information had been provided, (NOT the position he would have been in had the incorrect information been correct). There is likely to be a compensation element also for distress and inconvenience, which is generally in the region of a few hundred pounds.

Maladministration should not just be ignored because the distress and inconvenience awards are relatively small as the wider compensation element could be much more variable. In an Ombudsman claim (brought by Mr A Brown 83320/1) in 2012, the Ombudsman awarded nearly £5,000 because of additional legal costs expended a part of his divorce proceedings due to incorrect benefit information having been provided.

Another consequence of poor data could have potentially catastrophic effects. That is, incorrect funding.

The legislation and guidance around scheme funding is now immense and lays down a very prescriptive route to a very well defined aim, but it relies heavily on the data it is based upon. What if that data is wrong?

Changes in actuarial advisers can prompt a thorough review of data, often throwing up anomalies that mean the scheme has operated on a flawed basis for a number of years.

Tax consequences of data errors have been less of an issue since the Registered Pensions Schemes (Authorised Payments) Regulations 2009 made it clear that payments made in error will not count as "unauthorised payments" under the Finance Act 2004, provided they were believed to represent the actual entitlement. Prior to these regulations unrecovered overpayments would be "unauthorised" and result in tax charges of up to 70%.

A note of caution must be maintained, however, in respect of payments made in error after death. Pensions should stop on the pensioner's death, but where they continue to be paid in ignorance of the death, it is also possible to avoid being regarded as having made an "unauthorised payment" but only where the payments do not extend beyond 6 months after the death. Outside of this you are into the tax realm of unauthorised payments, so it pays to get your information right and up to date.

Something that should prick any trustee's ears up is whether faulty data could mean a discharge that the trustee was relying upon is actually invalid. Statutory discharges occur in a number of instances, such as on making transfer payments, buying out benefits with insurers and on scheme termination. These broadly discharge the trustees from further liability to provide benefits. But there is debate in the pensions industry as to the extent they effectively discharge trustees in respect of erroneous calculations. Certainly, Ombudsman cases regarding incorrect transfer values have not referenced the previous trustee discharges, which some commentators take as an indication that the Ombudsman's Office did not think there had been a relevant discharge in respect of the error.

In the case of buying out benefits, the insurance wording will often be carefully presented so that the insurer has accepted liability for that which it has been told about – leaving open the question about who is liable for something as yet unknown because of an undetected error.

Aside from the Pensions Regulator pointing to enforcement of s.249A of the Pensions Act 2004, there could potentially be scope for liability and fines under the Pensions Act 1995, the Finance Act 2004 and under the Occupational Pension Schemes (Disclosure of Information) Regulations 1996. They state that "amounts of… .benefits" must be provided to a member. It is perhaps arguable that this has not been complied with, if what is presented to a member is in fact incorrect. A failure under the regulations can result in a civil penalty of up to £5,000 for an individual or £50,000 otherwise. Also, an employer breaching its duty under the Occupational Pension Scheme (Scheme Administration) Regulations 1996 to disclose to the trustees on request "such information as is reasonably required for the performance of the duties of the trustees…" is punishable by a civil penalty of up to £5,000 for an individual or £50,000 otherwise. The employer therefore also has a vested interest in ensuring that the data it provided to trustees is robust and accurate.

The ignored cousin?

As mentioned at the start of this article, the member-data obligations and clean up that trustees have been focusing on over recent years are just part of the picture.

Trustees, along with many other entities, are subject to the requirements of the Data Protection Act 1998 and its associated regulations. Despite being 16 years old, this legislation has not been something trustees or indeed their advisers have generally spent much time considering, certainly not any deeper than at surface level. Well, with stringent new EU legislation just around the corner, this cannot continue for much longer. More of that later, for now let us revisit the current requirements.

Entities may either be classified as either a "Data Controller" or a "Data Processer". The administrator of a pension scheme to whom all day to day duties are outsourced would be the Data Processor. But, it is the trustees, as Data Controller, that bear all responsibility under the Data Protection Act, a fact that is frequently overlooked.

As Data Controllers, the trustees are required to notify this status to the Information Commissioner's Office ("ICO") and renew annually. Failure

Comment

to do so is a criminal offence.
The trustees are also responsible for complying with the eight data protection principles under the Data Protection Act:

- fair and lawful processing
- processing for specified and lawful purposes
- processing must be adequate and not excessive
- accurate and up to date data
- data must only be held for as long as necessary
- processing only in accordance with rights of data subjects
- secure processing
- data not to be transferred outside EEA unless safeguarded.

With quite onerous responsibilities on trustees, they should be checking that these are adequately passed on to those handling data on their behalf. Contracts need to be clear to ensure that the same level of compliance with the data protection principles is passed on and specifically and robustly cover protection of data by the administrator. It is often the case that contracts contain quite superficial data protection wording, perhaps because they tend to originate from the administrators who, as data processors with no free standing legal responsibility, have tended not to be as worried about the Data Protection Act.

Similar to the Pensions Regulator, the Information Commissioner has powers of enforcement, including the power to issue fines of up to £500,000. It has usually chosen to issue a monetary penalty where there have been security breaches, such as in the case of the Scottish Borders Council in 2012.

The Scottish Borders Council had taken on a third party to digitise its records but was issued with a £250,000 fine by the ICO when 600 files of confidential information were found in a recycling bin, having been dumped by the third party. As the Scottish Borders Council had not sought any guarantee as to security and protection of data from the third party, the ICO took a dim view.

Whilst security breaches have thus far been the main source of fines, there is a suggestion that things may be changing. Also in 2012, Prudential was fined £50,000 when tens of thousands of pounds destined for one particular retirement account ended up in the wrong account because of a mix up due to two customers sharing identical names and dates of birth. This fine has generated a lot of interest in the industry as it represents the first use of the ICO's powers to fine outside of security breaches.

The future is coming ...

This seeming increased willingness to use powers more punitively might be seen to dovetail with the EU changes on the horizon and the "beefing up" of the ICO's powers. One area set to dramatically change is the level of fines. The current maximum of £500,000 could increase to €100m or 5% of worldwide turnover under most recent drafts.

The changes will be implemented by EU Regulation rather than by Directive, meaning there will be no opportunity for individual member states to tailor the provisions. Many changes are currently planned, but those that may particularly impact on pension schemes are as follows.

Consent – consent requirements become more explicit and valid consent is unlikely to be implied where there is an imbalance of power between the data subject and the controller. Schemes will have to think about the consent they have from members and consider what steps they might need to take to be compliant, both in respect of new members and existing ones.

Enhanced data subject rights – the new regulations will bring in extra rights for data subjects which may have an impact on the administration of a scheme. There will be a new right to be "erased" and have all personal data removed from records. This could cause quite a bit of friction in the context of a pension scheme where data is usually held for a very long time and for many different purposes. The right not to be profiled – meaning a person cannot be subject to any measures based on automated processes which use personal data to analyse, evaluate or predict performance at work, economic situation, location, health, personal preferences, reliability or behaviour – could impact on matters such as actuarial valuations or ill-health pension requests.

In addition there are to be a number of extra administrative requirements which data controllers and processors will have to comply with. These may even require the appointment of a data protection officer for some schemes.

Failures will be much more stringently treated under the new regime, with immediate notification obligations to the Information Commissioner and possibly even to the data subjects themselves, and the much larger penalties mentioned above.

Trustees will not be the only ones having to pay more regard to the new requirements as the roles of data controller and data processor have been redefined and for the first time, data processors will have direct liability for aspects of compliance in their own right.

The new legislation has dragged its heels, continually getting stuck in the EU legislative process but indications are that after the EU parliamentary elections in May the pace will pick up and we could still be looking at 2016 implementation. It's therefore definitely worth considering what state you are in well beforehand as it's clear we can expect much more, not less, regulation, guidance and control.

Louise Howard
Senior Counsel
L.Howard@taylorwessing.com
www.taylorwessing.com

‘We do not need 80% of active management’

Michael Johnson Research Fellow, Centre for Policy Studies

Recently, robust, independent and damning evidence emerged that skewers any justification that active fund management of listed assets is worth the candle. For dispassionate observers, it has been long overdue, but the source was unexpected: the UK’s Department for Communities and Local Government (DCLG).

The catalyst was a growing concern for the sustainability of the Local Government Pension Scheme (LGPS), a disparate collection of 89, predominately sub-scale, funds in England and Wales.

DCLG issued a consultation paper proposing that all of the £85bn of externally actively managed listed assets should be moved to passive fund management, to reduce costs. In addition, all “fund of funds” arrangements should be replaced by one investment vehicle for alternative assets. Total cost savings of £660m per year are expected, and £6.6bn over the next 20 years – monies that would no longer reach asset managers’ pockets; a saving for taxpayers.

But even more important than this, the underlying research report, independently produced by Hymans Robertson, has been put into the public domain. Sponsors, trustees and members of private sector schemes are now free to digest evidence derived from both the huge LGPS data sample (the LGPS dwarfs any other UK pension scheme), and internationally. They will find that, on average, any additional performance generated by active management (relative to the benchmark indices) is insufficient to overcome the additional costs. It is better to invest passively, tracking the appropriate index.

Active fund management has finally been revealed for what it is: a web of meaningless terminology, pseudoscience and sales patter. For too long, active managers have been allowed to shelter behind their standard disclaimer concerning the long-term nature of investing. But the long term never arrives. It merely shuffles forward; there is never a day of reckoning. In the meantime, ludicrously expensive talent is deployed in the pointless pursuit of continually trying to outperform one another. Worse, it is a giant negative-sum game in which the savers pay the price, their hard-won capital persistently eroded by recurring charges and fees.

Data shows us that the dominant contributor to total returns is the asset-class mix, not individual stock selection. In practice, some so-called active managers are actually “closet trackers”. Once their high costs are deducted, the outcome of sub-index performance is no surprise. To misquote Sir Winston Churchill: never is so much being taken by so few from so many, and for so little in return.

But what of the so-called “star” managers? Every quarter, F&C Fund Watch publishes consistency ratios measuring the proportion of funds in the 12 main IMA sectors in the UK that produced top-quartile returns each year, over the prior three years. In the first quarter of 2014, of 1,069 funds, only 46 consistently produced top-quartile returns (ie 4.3 per cent). Using blind luck, one would expect 17 funds to achieve this, which leaves 29 fund managers out of a universe of 1,069, roughly 2.7 per cent, who could legitimately claim that their success was down to skill. Over the same period, only 188 funds (17.6 per cent) consistently produced above-average returns; 881 funds did not.

In addition, the last quarter’s results are towards the top end of historic ranges. A stunningly small number of funds beat their peers on a regular basis, but the crucial point is that at the start of any three year period, no one knows which funds they will be. Hindsight being useless, this is active fund management’s Achilles heel, and the crux of the debate.

Costs are controllable but, by and large, investment performance is not. This is not a recent revelation. Warren Buffett said: “By periodically investing in an index fund, the know-nothing investor can actually outperform most investment professionals.” Meanwhile, by publishing the underlying research, DCLG has introduced a degree of transparency hitherto unseen in public service pensions. But more significantly, it has acted on the evidence that lays bare the nonsense that is the active fund management of listed assets. If private sector schemes were to follow DCLG’s leadership and common sense, the implications would be profound. Millions of scheme members would benefit, and it would become apparent that we do not need 80 per cent of the industry. The remaining 20 per cent should focus on adding value in the unlisted asset arena that lacks the indices required by (passive) tracker funds to replicate investment performance, principally “alternative” assets, property and emerging markets and smaller companies funds.

Indeed, DCLG’s actions mark a seminal moment for all occupational pension schemes. Activity in the Twitter sphere would appear to corroborate this view. Jeremy Cooper, who chaired 2012’s review of Australia’s private pensions system, said: “What an astounding result. It will be a global litmus test.” DCLG should be congratulated.

Michael Johnson
Research Fellow
Centre for Policy Studies
majohnson@talktalk.net
Twitter:@Johnson1Michael
www.cps.org.uk

Comment

How to improve DC outcomes

Sarah Smart Chair
Anthony Charlwood Investment Officer, The Pensions Trust

The Pensions Trust is the UK's largest specialist provider of pension schemes for the not-for-profit sector in the UK. We have been providing DC schemes since 1988 through a master trust structure – a term which has become familiar with the arrival of commercial master trusts. Last year we re-launched our DC offering on a new platform – SmarterPensions. We moved to a Target Date Funds default investment strategy and also offered an Ethical Target Date Funds range – the first of its kind in the UK. We currently have over 60,000 members and 1,000 employers using the platform and in the order of £300 million DC assets.

The Pensions Trust is a mutual organisation with a vision of 'making membership worthwhile'. We believe in this passionately and will challenge accepted norms to achieve it. For DC this translates into a real commitment to delivering good outcomes for our members.

So what makes a good outcome? Certainly it's getting from A to B as efficiently and quickly as possible. Easier said than done if you are taking part in a trans-Africa car rally! Sand dunes and dust storms are likely to be encountered. If you lose your way you are in serious trouble – as Mark Thatcher found out when his mother was Prime Minister.

What are the sign posts for a good outcome? First, have a good idea of the nature of the situation you are going to find yourself in. Second, have the ability and the means to prepare appropriately for the situation. In other words follow the Scout's motto 'be prepared.'

How does this relate to a good DC pensions outcome? It all relates to the individual member's experience. It starts with the member's expectation of the level of income they will have in retirement. Then the tools must be available to give the members a good chance of achieving that level of income in retirement. Nothing is certain in life, and certainly not in retirement; we are looking to maximise the likelihood in achieving a member's expectations.

But all the preparation in the world will not produce a good outcome unless what constitutes a good outcome is clearly defined. The Pensions Regulator has laid out six principles, covering areas such as governance, administration and communications, which are supposed to lead to 'adequate retirement income'. But this good outcome is not defined! Surely it's time to take a step back.

So the first priority is to create a reasonable expectation. We can talk about 'income replacement ratios', but for the member it is really what sort of life style they want in retirement. This is a personal choice but has to be anchored to a realistic framework. That's why we have to engage with the member about contribution affordability, time to retirement and willingness and ability to cope with a result that is different from expectations.

Over our working lives our expectations change as do the factors which affect affordability (e.g. children at university) and capacity for risk. (How long can we afford to take to recover from a decline in the value of our retirement savings?) We need to develop tools to engage heuristically with members when they enter the scheme and then engage on a regular basis. (This is not a simplistic approach to assessing attitude towards investment risk!)

Creating a reasonable and appropriate expectation of income in retirement which the member buys into is hard, but until it is done how can the pensions industry 'deliver'? Unfortunately tPR has focused just on the delivery, not on defining and managing expectations.

One of the big challenges is that it is not easy to engage with your whole membership cost effectively – particularly not as the focus continues to be on driving costs down. The government is pushing us into a low charges regime without regard to the implications for member engagement. At the Trust we have put a great deal of focus on developing scale in SmarterPensions so we can develop great tools to engage with members without costs becoming unviable.

The engine in the toolkit is the investment choice. To manage the investment engine we need a reasonable outcome and target. Retirement expectations are in benefits framed in real terms (number of cruises, size of house etc.) and so it is appropriate to frame the return objective of the member as, say, CPI + 4% p.a. (as is the case with The Pensions Trust's SmarterPensions Target Date Funds). If a member joins the scheme midway or later in their working life, the real return expectation will be lower (because the capacity for risk will be lower).

The reality is that members are rarely in the same fund from its inception to its close – people come in part way through and they leave part way through as well (particularly once we have moved to the 'pot follows member' world). Of course, it is difficult and expensive to measure the experience for each member, so as an industry we don't do that. What do you do when you have two members in the same fund – one travelling towards a great outcome and the other (who has joined later in their working life) on a rocky road to a bad outcome?

The old adage states that what gets measured gets managed. Even if we cannot do this cost effectively at the individual member level, we can do this for different cohorts of members. We are working with our fund provider to provide this information in an accessible way.

One way to reduce this likelihood of failing to meet expectations is to reduce volatility. The new generation of Target Date Funds use tactical asset allocation techniques to dampen volatility i.e. exposure to downside risk. This will help deliver returns more in a 'straight line', limiting the chances of a new member suffering a loss.

We need to return to the contentious matter of fees. While it is undoubtedly true that the fees charged to the member's account will detract from investment performance, another adage 'you get what you pay for' is also true. A low fee product will restrict the investment choices and this limitation may impact long-term investment performance and the ability to reduce volatility. To further reduce volatility we want to use so-called alternative assets where the fees are higher than for, say, tracker equity funds.

The government has proposed both a greater disclosure of fees and a charge cap for DC products. Details have yet to be revealed. However, the government sponsored DC provider NEST has already set a low defacto ceiling for charges. While it is laudable in principle for charges to be made transparent, it is must be remembered that there is no such thing as a free lunch. There is a danger of a dash to the bottom in terms of charging which may not be to the benefit of all members. Limiting the investment choices to index-tracking passive funds may not only dampen return expectations but may well restrict the ability to deal with risk through diversification. The overall fee for members in SmarterPensions DC is 45bp – this covers governance, administration and investment.

A structure that we think is workable makes effective use of base fees and a properly structured performance fee element. A fund with a 15-20bp base investment management fee which comes out of the overall charge and a performance element which comes out of the return earned by the member is a much better structure than the flat fee cap proposed by the government.

To stay with the motoring analogy, if you only pay for a Micra, you cannot expect all the features of a Porsche. Perhaps we need to 'pimp' the Micra – it is still low cost but you can pay a bit more for a better ride.

Your investment manager must have a full toolkit at their disposal. As the member approaches retirement income generation will become an increasing component of return over capital appreciation. In the last few years before retirement liquidity (the ability to readily realise the portfolio, at a stable value) will become a paramount requirement. However, uncertainty has been introduced – employees can now continue working until they chose not to. For this reason SmarterPensions Target Date Funds keep 20% of the fund in growth assets at the member's expected retirement date.

However, there is a need for liquidity at any time, because a member can leave the Scheme at any time. This does not mean every asset has to be liquid, but illiquid assets can be rocks along the road. A growing, decent sized DC scheme can certainly cope with a modicum of illiquidity. For Target Date Funds the need for greater liquidity for those funds at the pre-retirement stage can be met by 'selling' illiquid assets to funds at the young/adventurous stage. This does raise the issue of how to value illiquid assets for such transfers and depends on a stream of new members entering the Scheme at an early stage of their working lives.

Now, to reiterate, the aim is to meet each member's expectations for income at retirement. The Chancellor in the Budget on 19 March 2014 revolutionised pensions (according to the headline writers) by abolishing the requirement to purchase an annuity on retirement and lowering the tax rate and relaxing the rules on income drawdown for members of DC schemes. Thankfully, members of DC schemes will be entitled to free financial guidance on retirement from April 2015. It can no longer be assumed that income in retirement will be taken through an annuity. Does this mean the structure of DC funds need to be redesigned? It can be argued that if a member uses drawdown, the shrinking asset pot should be invested more aggressively in growth assets. But can the member cope with the higher volatility?

A DC pension is a truly long life product - 60 years or more from the start of saving to when that last monthly payment is made into your bank account. Unsurprisingly there are no guarantees. Only through exposure to growth assets which deliver a return well in excess of inflation can a member expect a reasonable level of income in retirement. Yet members are only exposed to growth assets for a fraction of their time in the fund – 40 years at the most and then only partially in later years. Using drawdown when the member's pot is only around £30,000 at retirement (as will be the case for most of the Trust's members) is not an option.

Our investment provider is leading the pension industry's thinking on the bridge between saving for retirement and taking income on retirement. The re-writing of the rules by the government underlines the importance of delivering better outcomes through retirement. No one wants to run out of money!

The big challenge for DC providers is to devise ways to measure whether outcomes can be expected to be 'good' or not. Then members need tools to help them understand if the outcome looks good for them. The vehicle cannot just be driven in a straight line – the whole process is dynamic. The toolkit must be sufficiently large to adjust to optimal to help deliver these good outcomes for the members. An adaptable 4 by 4 may be a better choice than a Porsche Boxster. If you buy a basic vehicle you may end up paying more to upgrade in order to avoid a very unsatisfactory outcome for members. Our advice: look under the bonnet of your DC scheme, know where the members want to end up, take a map and avoid those sand dunes!

Sarah Smart
Anthony Charlwood
The Pensions Trust

The Draft Code – "good in parts"?

Matthew Demwell Partner, Mercer's Financial Strategy Group

Scheme Funding – the new Code of Practice

The Pensions Regulator (TPR) has published and consulted on:

- a draft new Code of Practice on funding defined benefits schemes
- its proposed Funding Policy and,
- its proposed Regulatory Strategy,

Collectively referred to as the Draft Code in this article.

The apocryphal curate was, of course, trying to be polite about his stale egg. An egg, of course, can only be either good or bad. The Draft Code, however, really is good in parts – and, in the author's view, not so good in other parts. But, to mix metaphors, the good parts sometimes feel like needles in a very large haystack. Here are some of them…

The Draft Code retains the existing Code's exhortation for deficits to be made good "as quickly as the sponsor can reasonably afford". Some believe this goes dangerously beyond TPR's brief and the legislative requirements. What I like about it is that it leaves trustees to decide what is "reasonable". If they agree that lower contributions and higher investment in the business in the shorter term optimise the longer-term security of benefits without compromising the needs of the scheme or requiring excessive or unnecessary risks to be taken, then this form of words enables them to make that call. TPR's proposed new statutory objective is to minimize any adverse impact on the sustainable growth of the sponsoring employer in relation to how it regulates the funding regime. TPR's encouragement to trustees to take this objective into account may also help trustees to make such a call.

I also like that the Draft Code makes "no presumption of conflict" between trustees and sponsors: this is surely a mindset to be applauded.

The Draft Code reiterates the importance, highlighted previously by TPR, of an integrated approach to risk management. Mercer has been using such an approach for some time so it will be no surprise that I support its wider application. However, it may mean different things to different people so I will return later to what it looks like in practice.

There is considerable emphasis in the Draft Code on meaningful covenant assessment. Some trustees have historically relied on in-house covenant views without external challenge or confirmation. This may be appropriate if they have sufficient experience, expertise and independence, but the bar is high and I fear some trustees may limbo under it rather than Fosbury-flopping over.

The Draft Code also emphasises the importance of good governance. Covenant assessment is a good example of an area in which a range of shortcomings can be summed up as poor governance.

Finally, I applaud the Draft Code's recognition that member security does not only mean cash contributions. This is potentially a hugely important observation. Unfortunately, TPR goes on to undermine it elsewhere, as I will explain later.

The Balanced Funding Outcome (BFO) and risk assessment

The BFO is not intended to form any kind of funding objective for trustees. It is simply part of an assessment process that TPR will use to determine whether to investigate schemes in more detail (in other words, to decide how to effectively allocate its limited resources). Under the Draft Code, TPR proposes to calculate a normalised deficit contribution amount for an as yet undefined 'medium term' recovery period based on a desktop assessment of a scheme's notional Technical Provisions, which will be determined based on its sponsor's covenant and the scheme's maturity. It will then compare this with the scheme's actual recovery plan contributions in order to assess whether the plan meets its expectations.

TPR also proposes to consider a wide range of qualitative risk measures including, for example, investment strategy risk, the funding assumptions for longevity and any reports of material poor governance. A decision will then be taken on whether to investigate a scheme further.

As well as using the BFO to help decide when to intervene, TPR says it plans to use BFO data to inform the "impact of our approach".

It appears that TPR feels under pressure to be transparent so it has set out quite a lot of detail about the BFO and the above process. Some are calling for even more transparency e.g. TPR informing each scheme what its BFO indictor is, whereas others feel that a tool for allocating TPR's resources would more safely be kept as an internal tool, to avoid unintended benchmarking effects.

A word about smaller schemes. Overall, the Code is potentially burdensome and TPR recognises this in calling for proportionality. However, in describing its risk-based approach to regulation, TPR appears to send out a message that it is too busy to investigate smaller schemes. Members of smaller schemes may not find this very comforting (nor trustees if they are hoping for support from TPR in challenging uncooperative sponsors). My suggestion would be that trustees of smaller schemes should continue to challenge themselves to reach appropriate funding solutions and to retain a rigorous audit trail for their decisions, since this will be in their members' best interests. Also, there can be no guarantee that they won't be subject to regulatory scrutiny at some point and TPR has made the point that it expects the same standard of behaviour from small schemes as it does from large schemes.

My views? Technically, TPR should:

- Drop scheme maturity as a component of the BFO metric. What matters is whether the overall investment, funding and covenant package provides enough security for the scheme and is sustainable for the employer, regardless of scheme maturity.
- Include investment strategy in the BFO, which would appear to give it more prominence than its current position in the "miscellaneous" box.
- Explore ways of capturing those miscellaneous risks more objectively without being too resource-hungry e.g. a few simple questions in scheme returns (or elsewhere) and utilisation of expert systems to evaluate the answers and probe more deeply where appropriate.

As to how the BFO is used in practice, I think TPR should:

- Say less, not more, about it. Treat it as merely an imperfect (but "good enough") internal desktop exercise that helps to inform when TPR should allocate resources to investigating a scheme further.
- Avoid placing greater emphasis on the BFO by using it as a way of measuring TPR's regulatory effectiveness.
- Encourage trustees, sponsors and advisers not to spend time and money trying to second-guess their BFO indicator and instead concentrate on appropriate strategies for their own schemes.
- Ensure its caseworkers consistently recognise and apply the principle that a scheme can fall below the "BFO bar" and still be appropriately funded and managed.
- Avoid sending a message to smaller schemes that they're virtually exempt from regulatory supervision.

Motherhood and apple pie

There's a lot of these in the Draft Code but they aren't necessarily any more palatable than the curate's egg. For example, on risk taking, TPR says it has stopped referring to self-sufficiency and accepts some risk is permitted, but then says all risk should be managed and mitigated. Its messages are not clear.
Specifically, the Draft Code:

- Is far too long & repetitive and may not therefore receive the attention it deserves from trustees and sponsors.
- Contains too much detail which risks becoming quasi-legislation (we've seen this happening with the existing code).
- Should set out principles and expected behaviour clearly and concisely (some of this is already there but is buried).

"Whose new statutory objective is it anyway?"

Is it appropriate for TPR to fulfil its new statutory objective by delegating responsibility to others? That appears to be what it is doing when it tells trustees they "should ensure that their decisions do not… unreasonably impact on the employer's sustainable growth plans". Is this really something that can properly drive trustees' funding strategy or is it up to sponsors to make their case?

It might be more helpful to have some clarification of what sustainable growth means and how trustees might balance potential conflicts between member security and the sponsor's sustainable growth (or indeed how TPR itself intends to balance its own conflicting objectives).

Some other suggestions

I mentioned earlier the Draft Code's recognition that member security does not only mean cash contributions. I am a supporter of the "as soon as reasonably affordable" expectation. What I don't like about it is that it refers to funding *the scheme*: this could be improved by referring to funding *benefits*. Funding outside the scheme can be a particularly powerful way of aligning member security and avoiding damage to the sustainable growth of the sponsor because it can:

- Increase the sponsor's willingness to commit funds by reducing concerns about trapped surplus.
- Enable funding to be used in the business, thus supporting the covenant, rather than being invested in competitors' businesses and other investments of the pension fund.
- Enhance the sponsor covenant both because of the previous point and also by building in suitable levels of security and bankruptcy remoteness (perhaps including elements of contingency e.g. increased security in pre-determined circumstances).

Consider the following example:

- Sponsor contributes 100 to scheme.
- Scheme uses the 100 to purchase an asset that promises an income stream and future capital payment.
- So the scheme no longer has the 100, only a promise – could the trustees be criticised for buying that asset rather than holding onto the 100?

Well, that's what trustees do every time they buy shares or bonds. But alternative funding can provide comparable returns together with a level of security (e.g. protection from sponsor insolvency) greater than that of many traded investments.

Compared with an unsecured recovery

plan, alternative funding (such as asset backed contributions, reservoir trusts and charged accounts) can simultaneously provide more security to a scheme AND support sustainable sponsor growth. At the same time, I fully endorse the need to have a credible fallback funding plan if the type of alternative funding chosen turns out to be legally flawed.
So what should trustees and sponsors actually be doing?

Top tips for trustees and sponsors

DO the right thing (independence, advice, robustness, proportionality, integrated approach, audit trail)

DON'T obsess with TPR covenant grades and BFO: reflect the unique circumstances of your scheme and sponsor

DO remember: it's not trustees' role to discharge TPR's responsibilities (even if TPR tries to put that responsibility on trustees as under the Draft Code) but they should be open to reasonable sponsor proposals subject to not compromising the needs of the scheme nor taking excessive risks

DO practice integrated risk management; consider forward-looking and action-focussed covenant monitoring

What does "integrated risk management" look like in practice?

A detailed treatise on integrated risk management is beyond the scope of this article. However, the comments below are designed to indicate its key features.

There are many potential ways of mitigating pensions financial risk, although they can mostly be grouped under the following headings:

- Additional funding from the sponsor.
- Covenant enhancement.
- Investment strategy de-risking.

Mitigations vary in their profile and impact. An integrated approach enables the value of alternative mitigations (and combinations of mitigation) to be assessed consistently. This involves adopting a consistent approach to valuing scheme assets and liabilities, investment risk and the sponsor covenant. Key benefits of this are that:

- The sponsor and the trustees are working with a consistent, pre agreed methodology, which reduces complications due to differences in approach.
- It enables alternative mitigations such as additional funding, investment strategy de-risking and contingent assets to be evaluated consistently.
- It enables the sponsor to propose mitigations, where necessary, that reflect its own objectives and constraints (e.g. availability of cash, risk appetite, availability of alternative forms of security) with a good understanding of how the trustees will assess its proposals.
- As well as meeting the trustees' requirement for an integrated approach (I am starting from the viewpoint that they should have such a requirement), it also satisfies TPR's requirements.

What does "forward-looking and action-focused covenant monitoring" look like in practice?

Much covenant monitoring relies on historical information and is, in a sense, out of date as soon as it is considered. Forward-looking indicators can provide early warning of potential problems and can thus enable mitigating action to be taken before it is too late. Such indicators include:

- Management forecasts.
- Where traded, the price of credit default swaps on the sponsor's corporate debt.
- Commercially available indices.
- Equity prices (and especially volatility relative to the market / peers) to the extent one believes that this reflects all known (including forward-looking) intelligence.

Action-focused monitoring involves identifying key metrics (e.g. based on one or more of the above but possibly also including historical data) and setting triggers which, if breached, will drive action. Broadly, "action" means the sponsor selecting from a pre-agreed menu of mitigations and proposing one or more, which, when combined, will restore the scheme's level of security (measured using the integrated approach described above) to within a pre-agreed acceptable range.

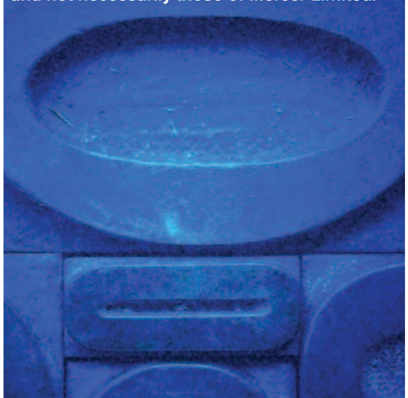
Triggers could include "amber light breaches" resulting in a lower level of intervention such as implementing negative pledges or putting contingent assets in place, and "red light breaches" that would trigger more concrete mitigation.

The key here is to have all the (potentially difficult) negotiations and reach agreement before the problems being anticipated arise and independently of other discussions, such as a triennial valuation. This is so much easier than waiting until a funding or covenant shock has occurred, which is usually the most difficult time to agree adequate mitigation. TPR's concept of 'contingency planning' ideally anticipates this kind of action-focussed monitoring in relation to covenant experience, and also in relation to investment and funding experience.

Matthew Demwell is a Partner in Mercer's Financial Strategy Group, which works with trustees and/or sponsors to determine pensions strategy and manage financial risks.

Matthew Demwell
Partner
Mercer's Financial Strategy Group
matthew.demwell@mercer.com
www.mercer.com

This article reflects Matthew's personal views and not necessarily those of Mercer Limited.



Dealing with Investment Risk

Paul McGlone Partner, Aon Hewitt

Scheme Funding – the new Code of Practice

If you search the internet for articles on managing risk, you will quickly find that there are four established ways of dealing with risk. They are often quoted as:

- Avoid
- Reduce
- Transfer
- Retain

The descriptions are pretty self-explanatory, and they apply to almost all types of risk.

Looking further still, you will find refinements of this model – and in particular, refinements of the "Retain" option, including:

- Exploit – a deliberate retention to gain some advantage
- Ignore – a 'head in the sand' approach or possibly an unconscious retention if the risk is not understood.

Investment risk is no different, and this type of classification provides a helpful framework for considering how we deal with the various risks to which investment exposes our pension schemes. It works in the context of both defined benefit (DB) and defined contribution (DC) schemes but the focus of this article is DB investment risk.

As the Pensions Regulator regularly reminds us, the extent to which a pension scheme can cope with investment risk depends crucially on the strength of the sponsor. Risk is mentioned no fewer than 84 times in the draft Code of Practice issued by the Regulator, and perhaps the biggest aim of the new code is to drive the link between covenant and investment risk. Paragraph 115 summarises the position nicely:

"If trustees choose to accept investment risk this should be supported by the employer covenant unless the trustees are satisfied that the likely risks to members are otherwise appropriately mitigated or are justifiable."

In that context, the six options for dealing with risk take on new significance. If the amount of risk that a sponsor covenant can cope with is limited, how do we best decide which risks to avoid, reduce, transfer, retain, exploit or ignore?

A world of risks

It's obvious to anyone who has been involved with pensions or savings that any type of investment comes with risks. And different types of investment clearly have different types of risk. Pension schemes also come with the added risk that the investments are not just seeking absolute returns, but returns relative to liabilities.

The variety of risks can be broken down in a number of ways, but for the purposes of this article I have split them as follows:

- Operational Risks : those associated with the physical activities such as trading or holding assets
- Financial Risks : those associated with the value of what you hold (relative to your liabilities), or being able to access that value

Operational risks

The combined assets of UK DB Pension Schemes total over £1 trillion, but around 70% of that is in just 200 or so schemes. For those largest schemes, operational risk is very real. Holding assets directly is fairly commonplace, and the range of assets that they hold is wide: gilts, bonds and equities, but also swaps, options, swaptions, and property to name just a few. With that activity comes a range of operational risks. Some relate to the activity of holding the assets (eg dealing with custodians, managing collateral for derivatives, ensuring suitable liquidity, stock lending policies etc) while others are more practical (eg dealing with data security, legal issues, fraud prevention, key man risk etc). Of course, those schemes also have the greatest resources to call upon, and have teams who will generally decide which risks to AVOID, REDUCE, RETAIN and so on.

Most schemes, however, have (rightly) delegated those chores to someone else. The remaining 95% of schemes, holding 30% of the assets, typically use pooled funds, and the manager deals with most of the operational risks. The effect of this is certainly to REDUCE the risk (as the issues are being looked after by experts), but it is also a risk TRANSFER; if something goes wrong then schemes have paid a professional to look after it, and would expect that a combination of their contract and the professional's professional indemnity (PI) cover would protect them.

In practice, however, that PI cover is seldom called upon. Although operational risks exist, actual problems are relatively rare in practice. That is in stark contrast to financial risk, where every scheme in the country will have suffered, at one time or another, from assets not doing what they expected.

Financial risk

Financial Risk is where pension scheme trustees spend a lot of their time - and as any actuary will quickly tell you, you have to consider both sides of the balance sheet: assets and liabilities.

Managing liabilities is not considered as exciting as managing assets, but before we discard them as dull, it is worth remembering two things. First, liabilities are bigger than assets. And second, liabilities are more volatile than assets. What I mean by that last statement is that the volatility of a long duration liability such as a typical active or deferred member is more volatile than the UK equity market. If you don't believe it, take a look – the impact of yield changes when magnified over many years is huge.

So let's start with thinking about the liabilities, and three risks in particular: interest rates, inflation and longevity. How do schemes deal with these risks?

Liability risks

Interest rate risk is often said to be a measurement risk only – it changes the assessed value of the liability but does not change the liability itself. In fact that's only partly true. If you want to secure benefits with an insurer – and most schemes do at some stage - then interest rate risk is very real.

Historically the reason that schemes did not remove this risk was 'we can't afford to' – their assets needed to generate return, and if they were generating return then they could not provide protection as well. That changed, however, with the use of swaps and leverage in pension schemes, which allowed schemes to TRANSFER that risk to someone else. Within a few years the concept had moved from the largest schemes to the mid market and now, through pooled funds, to some of the smallest schemes in the country. There is no longer any reason for most schemes to retain this biggest financial risk – and yet many schemes do.

Some schemes are, unfortunately, still in the IGNORE box – blissfully ignorant either of the nature of the issue or the existence of the solution. Some are happy to RETAIN it and have a full understanding of the situation. Another group is expecting to EXPLOIT the risk, as they believe that yields will rise faster than the market is pricing. For that group, the question is how long they maintain that position, and at what stage the risk stops being one that they believe they can profit from.

Inflation is a harder risk to deal with, although the same principles apply – you can lock in to inflation by using swaps or pooled funds. But here there are added complications:

- First, most benefits are not pure RPI – they have caps and floors, and different caps and floors pre and post retirement, and some of them are CPI linked rather than RPI, and that cannot be transferred as easily.
- Second is the inflation risk premium – there is a price to pay for protecting against inflation – an opportunity cost, if you like, as you expect inflation to be lower than the rate that you can lock in at. The current inflation risk premium is in the region of 0.5% per annum. That means that a scheme is paying something like a 5% premium above the expected cost of its benefits to remove the inflation risk. The question you need to ask is "is that a price that I'm prepared to pay?"

As with interest rates, inflation is both a real and measurement risk. It is real in the sense that we are exposed to inflation on a year to year basis. The measurement risk comes in the sense that expectations of future inflation drive the liability. And the ways of dealing with it are also similar to interest rate, with schemes regularly deciding to TRANSFER, RETAIN or IGNORE it.

The other option that exists for inflation, which has a knock on effect for other risks, is to REDUCE it through a Pension Increase Exchange (PIE) exercise. A PIE exercise converts certain inflation-linked pensions to flat pensions, and that means a number of things happen. First, the inflation exposure is reduced. But because of the different shape of the benefits, interest rate exposure and longevity risk is also reduced as well.

Other than a PIE exercise, which has a modest impact on longevity risk, there are only two realistic ways to TRANSFER longevity risk away from your scheme – a bulk annuity or a longevity hedge. The former are available to almost all schemes, but are not always affordable. The latter, however, is only currently available to the largest schemes. Fewer than 20 longevity hedges have taken place in the UK, and up to 2013 the smallest bespoke deal that took place was for £400m of pensioners. That will change, but for now they remain the preserve of the largest schemes.

Asset risk

Moving on to assets, the risk here is that return-seeking assets do not deliver what is expected, and that is usually characterised by short term volatility and long term underperformance.

Can we AVOID these risks? Yes, we can - but that involves not holding return-seeking assets in the first place, and most schemes cannot afford to do that.

Can we TRANSFER them? Schemes can use derivatives to transfer downside risk to someone else, but that has a cost which can be substantial over the long term (although it can be useful short term).

The most effective way to deal with these risks is to REDUCE them through diversification across multiple markets – something that every scheme is already doing to some extent. Equities are commonly diversified across regional markets, but many schemes do not diversify as much across asset classes (eg hedge fund, private equity, infrastructure, property).

Beyond market risk is manager risk - the risk that your manager underperforms. For a typical scheme that selects a single active manager, it feels like a 50/50 chance whether that manager outperforms the market or not. In practice that's not far from the truth (if any consultant could pick outperforming managers say 80% of the time then they would be sitting on a gold mine), which is why so many schemes would rather AVOID manager risk, by using the many index trackers out there.

But even if, for example, you only have a 55% chance of picking a winning manager, that's enough when used in the right way. If you walked into a casino and bet on a single game with a 55% chance of success then you either win or lose. But if you play all evening with a 55% chance of success then you have a strong chance of coming out ahead. Similarly, if you put together a suite of managers in a multi-manager portfolio then that will substantially REDUCE the manager risk.

In practice, constructing multi-manager portfolios is about much more than just picking winning managers. It is also about selecting managers that do different things. Different market conditions will favour different strategies and managers, and portfolio construction should allow for issues such as complementarity of managers. The optimal number of managers will be different in different markets based on how much of an opportunity there is in that market for active management. For most schemes, that level of complexity is beyond the resources they have at their disposal.

Dealing with the world of risks

The Aon Hewitt 2012 Mid-Market Survey asked respondents what worried them most about their pension scheme. The answers were not related to funding, investment, covenant or administration – they were about issues such as time, resources, cost and availability of knowledge. In other words, it is not just the pension issues that people are concerned about, but the operational challenges of dealing with them.

The quick canter through investment risk over the previous pages demonstrates this in detail. Investments are complex and numerous – and more complex and more numerous than they were even a few years ago. Faced with that reality, trustees need to consider how they deal with them. My own view is that they have three choices: Get Busy, Get Simple or Get Out.

Get Busy

Schemes that want to deal with all or most of the investment risks tend to have big pockets or big problems. Either they are large enough that they can devote the time to investment, or they simply cannot afford to not deal with them. For these schemes, busy can mean very busy - not just investment sub-committees, but far more frequent meetings and nominated trustees to spend a substantial amount of their time on investment issues. For example, a £2.5bn scheme that recently decided to 'get busy' has an investment sub-committee chair who spends one day a week on investment, and a consultant who spends 60-70% of their time just on that one scheme.

Get Simple

The option to Get Simple typically applies to schemes that are either small in absolute terms (in which case getting busy is not viable) or small relative to the size of their sponsor (in which case the risk is not a big concern). The investment structures tend to be made up of conventional asset classes (equity, bond, property) and passive managers. The time spent on investment governance is very low, and is best spent focused on the investment strategy (rather than different asset classes or managers). For example, a £20m scheme that recently decided to 'Get Simple' spends two to three hours a year on investment issues, and has put in place a structure that can be managed within that time.

Get Out

Genuinely getting out is not really possible unless you pass the scheme to an insurer. What I mean here is to delegate the issues to an expert third party – a fiduciary manager. If you want or need to Get Busy, but do not have the resources to do so, then this is the only option. It can apply to the scheme in full (ie by giving the fiduciary manager a mandate to manage all of the scheme's assets) or in part (eg by asking the fiduciary manager to just manage a specialist part of the mandate such as emerging markets). Either way the principle is the same – it's about paying someone to Get Busy for you.

All three of these options are perfectly valid, and different options will be right for each scheme. Fiduciary Management is not the right option for every scheme (despite what some providers would have you believe), but neither are the other two. Based on delegate responses at a recent conference, the split among schemes could be close to a third in each category. But regardless of what everyone else is doing, the immediate action for trustees of DB schemes are the same:

- Think about the various investment risks that you face
- Think about how you want to deal with those risks - Avoid, Reduce, Transfer, Retain, Exploit or Ignore
- Think about the resources you have at your disposal to deal with investment, and the importance of investment risk to your scheme
- Decide which of the three categories you fall into – do you Get Busy, Get Simple, or Get Out?

Paul McGlone
Partner
Aon Hewitt
paulmcglone@aon.com
www.aon.com

On target for a smooth journey

Tim Banks Managing Director, Pensions Strategies Group at AllianceBernstein

The myths of Target Date Funds

The importance of a good default fund has always been paramount. But it has become a higher-profile issue in the world of auto-enrolment. More people are being enrolled into defined contribution (DC) schemes who have never saved into a pension before. And many of these are 'accidental savers' – in other words, they are reluctant and unprepared. Indeed, our research shows that more than 90% of people will delegate their investment decisions, or be guided by others i.e. their employers.

Given this context, it's crucial for employers and scheme trustees to understand the implications of the default fund they are selecting for their members. The use of target date funds (TDFs) is becoming increasingly popular as a default strategy, which is especially well-suited to the 'accidental saver'. There are still, however, a number of myths being perpetuated that are preventing their proliferation. Here, we try to dispel those myths once and for all.

TDFs deny you access to open architecture

Untrue. While it is possible to construct a single-manager TDF if you wish, why would you? We know that fund managers are better at some things than others. Our TDFs embrace the best of open architecture.

But they're expensive, aren't they?

NEST uses them. In other words, the government-run pension scheme, which has a 'low-cost' remit.

Put it another way, you don't see the same criticism levelled against diversified growth funds (DGF). But where DGFs often charge 125 basis points (bps) as an annual management charge, our TDFs charge only 30 bps.

But you don't know when the investor is going to retire

That's true. None of us really knows the exact date on which we are going to retire. And yet, that's exactly what a lifestyle fund requires you to estimate 30 or 40 years in advance. With a TDF, you're only asked to estimate a 2-3 year window in which you might retire. That's usually more than adequate for effectively managing a glidepath to retirement.

And what's more, if an investor thinks they might work on another few years, then they can switch to a fund with a later retirement date range.

TDFs don't consider income

Again that's not true – and certainly not in the case of our TDFs. Speaking for ourselves, we proactively manage the duration of our funds in the same way as an LDI mandate or actively managed bond fund.

They're operationally difficult to manage

We seem to cope. Which is what matters, because unlike lifestyle funds, TDFs take the burden of switching away from the scheme administrators.

Aren't they like supertankers: tricky to change asset allocation?

Not true. When a lifestyle fund wants to change one of its underlying managers or shift the balance of its portfolio, it can take months or sometimes years. Before making a switch of one of the underlying managers, the manager usually has to seek the approval of the trustee board, and then write out to all fund investors for approval.

In the case of TDFs, to use an analogy, because the investor is simply buying a 'seat on the plane' and doesn't have to approve the change of every widget in the engine, they can leave that to the experts and that means they can make a change to any component in the fund in a matter of hours.

They're hard to benchmark

We think benchmarking is actually easier for a TDF than with a lifestyle fund. TDFs offer full transparency of both their dynamic asset allocation and also the underlying assets in each fund.

Are they really proactively managed?

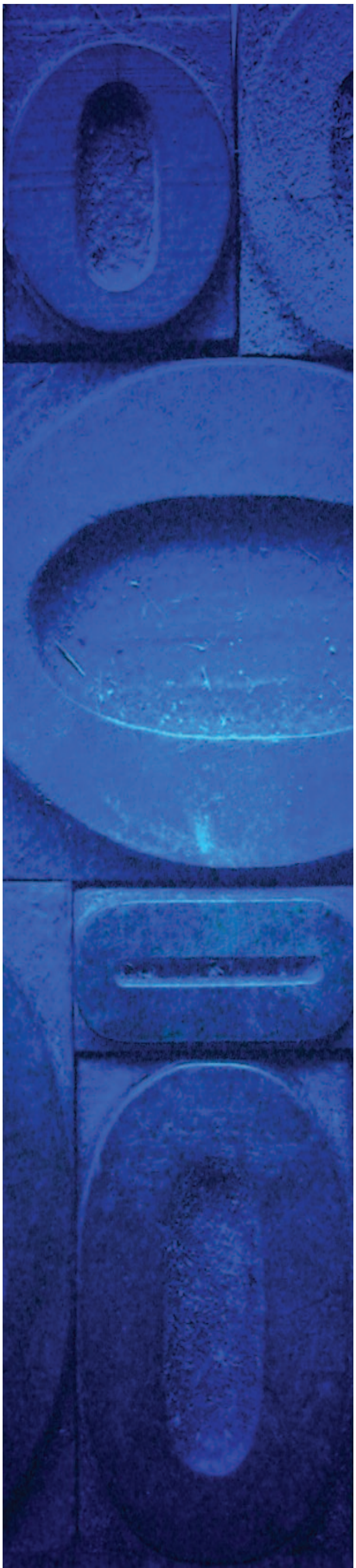
Yes. In fact, TDFs are not only more nimble than lifestyle funds, they can take proactive steps to deal with events that are going on around them – whether that be changes in market sentiment, asset price volatility, financial regulations or government legislation.

Returning to the air travel analogy, while a TDF can manoeuvre the vehicle quickly if it sees a storm on the horizon, the pilot of a lifestyle fund is looking only in the rear-view mirror, and therefore won't be able to respond to the storm until it's too late.

Conclusion

We believe target date funds are an ideal strategy for a DC default fund. The combination of their dynamically managed asset allocation throughout the savings journey, their flexibility to cope with potentially disruptive events in our ever-changing world, and their clarity of purpose to members make for a smoother journey. And in the new world of auto enrolment, providing a default strategy that can cater for 'accidental savers' should help future proof a pension scheme for the long term.

Tim Banks
Managing Director,
Pensions Strategies Group,
AllianceBernstein.
Tim.Banks@alliancebernstein.com
www.alliancebernstein.com



Practical legal risks: a review of claims and how to avoid them

Robert West Partner Baker & McKenzie LLP

We seem to be living in a claims-orientated society. That trend certainly manifests itself in pensions.

As a pension lawyer, I see many disputes and potential disputes crossing my desk. In this article, I look at some of the problem areas and the light which recent cases sheds on them.

The first group of claims tends to involve what I would call structural issues for schemes. Typically, these issues are addressed in the High Court and above.

There are three main problem areas that I tend to see confronting trustees. These skeletons in the closet frequently encompass defective attempts to equalise schemes after the Barber decision, defective conversion from defined benefit to defined contribution and, more generally, defective attempts to amend the rules.

In some cases, it may be difficult to put things right. Often, the problem arises from what represented quite understandable practice at the time. Looking, from the vantage point of 2014, at attempts to equalise benefits in the immediate aftermath of Barber puts scheme documentation under a degree of scrutiny which it sometimes cannot bear. It took some time for the European Court to give further guidance as to how Barber was to be applied in practice and this, allied with the discovery that equalisation could not readily be achieved retrospectively, has led to many issues for schemes.

Some of the problems which are surfacing now arise from the trend towards buying out benefits with insurers. In buy-outs, both the trustees and the insurer will want to be sure that the benefit structure is robust. A detailed review of scheme rules – and some of the historical changes to those rules – may well bring issues to light which need to be resolved. Similarly, scheme auditors now tend to ask more searching questions about scheme governance – and, in particular, whether benefits have been fully equalised for sex discrimination purposes.

In many cases, the courts have been reluctant to accept the validity of rule amendments where trustees have failed to observe the strict requirements of the power of amendment. BESTrustees v Stuart (2001) established that, if the power of amendment prescribes the need for a deed, failure to use a deed will usually invalidate the amendment. This may be particularly problematic where trustees have adopted the widely-used pre-Pensions Act 1995 approach of announcing a change but deferring the formal rule amendments to a later date. Similarly, in Walker Morris (2009), the court decided that the absence of an actuarial certificate (contrary to the strict requirement of the rules), invalidated a series of rule amendments spanning nearly 20 years.

But, if there is a problem, all is not necessarily lost. What is certainly needed is careful consideration of all of the angles, the taking of advice and working with your insurer. The recent cases of Premier Foods v RHM (2012) and Dresser Rand (2014) found, respectively, that a deed of intention and a notice to members may be sufficient to effect a change, depending on the nature of the scheme's power of amendment. Putting things right after the event may also be possible. The recent case of MNOPF v Watkins (2013) shows that it is perfectly possible to obtain rectification of defective documentation after the event. Indeed, in that case, the court was prepared to grant rectification on the basis of summary judgment, given the clear evidence that the relevant documentation did not reflect the true intention of the trustees at the time.

However, one of the potential remedies available to trustees – the invocation of the so-called rule in Hastings Bass – has been severely curtailed. Prior case law had shown a willingness on the part of the courts to overturn trustee decisions made in ignorance of material facts, where full knowledge either would – or even might – have caused the trustees to act differently. Unfortunately for trustees, the Supreme Court, in the Pitt and Futter cases (2013), has severely limited the remedy. In practice, it is now likely to be necessary for a trustee to be able to show that the trustee acted in breach of trust – and not simply in error – before the court will intervene. This may be particularly restrictive because, if the trustees sought and followed professional advice, it may well be impossible to establish the necessary breach of trust. In such cases, the only hope may now be rectification of the documentation or being able to demonstrate that a simple mistake has been made.

There is ample evidence from the Courts that the trend towards litigation is likely to continue. On 4 April 2014, the High Court delivered its judgment in an important case relating to the IBM Pension Plan. Following a 30 day hearing last year, Warren J ruled that IBM had been in breach of its duties to its employees in relation to the cessation of defined benefit accrual. The ruling, which highlights deficiencies in the communication processand the failure to meet the "reasonable expectations" of Plan members, may well cause other completed projects to be subjected to critical scrutiny, with the potential for costly litigation arising as a result.

Trustees are, of course, also vulnerable to claims from individual members. Typically, these are heard by the Pensions Ombudsman, but they may, on occasion, be heard by the High Court (either initially or on appeal). As an aside, it is interesting to note that, with effect from 6 April 2014, a member who is unsuccessful with his claim before the Ombudsman will need to obtain leave from the High Court, in order to appeal. This change in procedure has been introduced, I believe, in order to reduce the number of appeals from litigants in person who are attempting to argue factual, rather than legal, points on appeal.

The Ombudsman himself has highlighted many of the main problem areas for pension schemes in terms of member claims. Many of these points are addressed in the Ombudsman's 2005 publication "How to avoid the Pensions Ombudsman".

Particular problem areas are inaccurate benefit statements, incorrect payments, the provision of inaccurate information and delays in crediting and switching funds in defined contribution schemes. In many cases, the claims arise from a failure to process applications and take decisions in accordance with the rules of the scheme (notoriously, in relation to ill-health retirements and the application of lump sum death benefits).

A graphic illustration arises from the very recent Ombudsman case of Wood. The trustees decided in 2011 to end the provision of discretionary pension increases and notified members accordingly. However, on review, the Ombudsman found a number of problems with the way in which the decision had been approached. From a legal perspective, the Ombudsman found that the trustees had unlawfully fettered their future discretion, in breach of the requirement under the rules to review pensions regularly. The rules also provided for the discretion to be exercisable jointly with the employer, but the Ombudsman found that the employer had played no part in the decision. The Ombudsman also criticised the trustees for failing to identify relevant considerations (for example, the trustee had cited the need for consistency across the scheme where no uniform practice existed). Finally, the trustees failed to document either their reasoning or their decision.

As a result, the Ombudsman ordered the trustees to reconsider whether to grant increases in 2012 and 2013. He also ordered the payment of £200 to Mr Wood for distress and inconvenience.

Comparing this with some other recent Ombudsman decisions, the award for distress and inconvenience was somewhat on the low side, no doubt simply reflecting the facts of the case. The Ombudsman also reached a very different conclusion in the Frankham case (2013). Dr Frankham was given a letter promising certain pension increases which were incorrect and subsequently not paid. The trustees did not respond to Dr Frankham, the plan administrators or the Pensions Advisory Service and sent a delayed response to the Ombudsman. The Ombudsman awarded compensation of £1,400 for distress and inconvenience (£400 in relation to the misleading information and £1,000 in respect of the trustees' poor communication).

Overpayments of benefits are another fertile area for complaints. The tests as to whether the individual may retain an overpayment are somewhat similar in both the High Court and before the Ombudsman. Last year, the Ombudsman considered the case of Mrs McNicholas, who concluded a divorce settlement on the strength of a misquoted statement of her pension entitlement. As Mrs McNicholas had acted in reliance on the misquotation – and her divorce settlement could not be reopened – she was allowed to keep an overpayment of nearly £100,000. Similarly, in the John case (2013), a scheme member was allowed to keep overpayments amounting to £14,000 after taking action in reliance on the overpayment. The member sold his business, retired and gave lump sums to his children, all following receipt of the overpayments. The problem was compounded by the fact that the member questioned the overpayment and believed that action had been taken to adjust his overall benefits. The Ombudsman was satisfied that the member had acted in good faith. He balanced the injustice to the member of having to repay the money against the injustice to the administrator of not being able to recover it.

There are some useful lessons to be learned from these member claims. It is vital, in particular, that trustees should follow the correct process when dealing with both applications for benefits and complaints. Compliance with all requirements of the rules and internal dispute resolution procedures should be checked carefully. Medical evidence on ill-health applications should be reviewed carefully in order to resolve any uncertainties. When applying lump sum death benefits, trustees should fully inform themselves of the range of potential recipients and should have proper regard to the member's wishes. Overpayment claims should be handled promptly and unambiguously.

In summary, all complaints should be handled quickly and informatively. Members should be given full reasons for decisions and the outcome of their complaints in plain and simple language. Involving your professional advisors and your insurer can be key to both reducing and resisting claims.

Robert West
Partner, Baker & McKenzie LLP
Robert.West@bakermckenzie.com
www.bakermckenzie.com

DC Sector insight

Andrew Warwick-Thompson Executive Director for DC, Governance and Administration, The Pensions Regulator

As I'm sure you are all aware, this is an incredibly busy time for the regulator and I'm here today to give you all an insight into some of the many issues involving the DC sector that we are currently working on.

The reason that there is so much focus on the DC landscape is in part due to the roll out of automatic enrolment. Three million people are now saving into a workplace pension scheme for the first time – an incredible result when you stop to think about it - and with many more millions still to go through the process it means that there will be much more focus on DC schemes which most of these people will be enrolled into. Confidence in the marketplace is vital. We need to ensure that these people have confidence in their schemes and that these are run in accordance with our DC code, ensuring good member outcomes.

It also means that the DC market is starting to catch up to DB in terms of assets. At the moment there are over £1 trillion of assets in DB whereas DC currently stands at around £400 billion, across DC occupational, hybrid and workplace personal pension schemes. But that number will continue to rise steadily. At some point in the future the DC market will overtake DB. No one is sure when it will be but with the increase in members and assets under management it's not surprising that there is a lot more regulatory attention focused on DC.

In the past the regulator has highlighted – quite rightly – the amount of money in DB schemes as part of the corporate plan and other communications, but we have tended to shy away from highlighting the DC market in a similar fashion as information was limited. I hope to change this going forward and to highlight this burgeoning sector. You may have seen our DC Trust publication recently. It highlights some of the current trends emerging and illustrates, for example, the average retirement pot as well as giving more detail in the breakdown of scheme membership. I hope to be able to develop this in the future and make it even more informative.

We have also now published the results of our thematic review on record keeping standards and why it's so important to have accurate data. Record keeping is vitally important as it underpins the running of the entire scheme. It is only with the right records that you can ensure the right benefits are being paid to the right members at the right time. Our thematic review shows that there is still a lot of work to do to ensure that schemes are adhering to their record keeping obligations.

The main focus for this year is to "bed down" the code. The consultation process started back in 2011 – a long time before I joined the regulator. It's very much a product of consultation. Our ultimate goal was to create clear guidance on what would create a "good member outcome". After a great deal of consultation we turned those responses into six principles and 31 quality features that are now encapsulated in the code of practice and guidance, which we published last November.

For me the principles are of primary importance. If trustees have those in place – the characteristics, the clearly defined governance structure, which is then monitored, good administration, fit and proper people and communication with members, then I believe that you have the tools to secure a good member outcome, which is what we are all striving for.

The first major step in embedding the code has been the introduction of the voluntary governance statement earlier this year. Whilst it's not compulsory it provides a template which trustees can use to decide how their scheme stacks up against the code. We expect this statement to be renewed annually by trustees, perhaps as part of their annual reporting cycle. Once completed it should be made available to members and employers, for example by publishing it in the scheme's annual report and accounts or on its website.

It's designed specifically to be a self-audit - something trustees who have the requisite knowledge and understanding of their own schemes can undertake. They can ask themselves: "are we doing the right things and do we have the right features in place?" It's almost like a guide to a discussion at a trustee meeting. Additionally it provides a paper trail, so that when the regulator asks what they are doing they can easily demonstrate what actions have been taken.

The aim of the voluntary governance statement is to help drive up standards and it will help trustees to focus on their scheme, ensure any problems are identified and an action plan is drawn up to deal with it. It also helps to inform members of the health of their scheme and provides them with the confidence that any potential problems are clearly being handled in an appropriate and timely manner by the trustee.

Although there are some elements of the DC code which are prescriptive, because they are underpinned by legal requirements, an awful lot of the code is about good/best practice and what it looks like. You might have a slightly different approach and I want to emphasise that there is room for this. Providing you are complying with the law and providing you can evidence that your scheme exhibits the 31 quality features then we are happy. No two schemes are the same and we are trying to create a situation where all schemes are focused on best practice and will be able to improve retirement incomes for their members.

So that's the purpose of our voluntary governance statement. The response so far from trustees has been broadly positive. We have had some criticism about its usability and whether trustees are really going to do this themselves or get their advisers involved. I strongly hope that trustees will engage with this themselves. I think if you are a trustee you should have sufficient knowledge and understanding about your scheme and that this shouldn't prove problematic for you.

Moving on to master trusts. These are going to play a key role in the new DC landscape and should be able to deliver good member outcomes through economies of scale, professional governance and the consolidation of resources. There are potential risks associated with conflicts of interest, complex investment structures and a potential lack of independent oversight in some as well as an absence of market entry barriers. Added to this we have seen a huge rise in these trusts coming into the market – we believe that this number is now over 70, which we consider to be far too high if we want good economies of scale and quality schemes.

In order to deal with our concerns we have been working in conjunction with the ICAEW on producing a voluntary independent assurance framework. Designed around our DC quality features, our master trust assurance framework focuses on both the areas specific to master trusts as well as wider governance issues. This was subject to a public consultation which closed at the end of last year. Again, it was generally received positively. What we are encouraging, on a voluntary basis, is for master trusts to go through this process if they want us to signpost a particular master trust – like we do with Nest at the moment. Trusts should see this as a commercial incentive to seek independent assurance. We also hope it will act as a barrier to entry for less viable master trust propositions.

The regulator is also working on additional assurance frameworks, for example we are working with the industry and stakeholders on a possible assurance framework for GPPs and we are working with PASA on accreditation for administrators. I hope to be able to update you more about this work in the months ahead.

So how does this all fit together? I see it as a layered pyramid. Right at the base is pensions law which legally underpins all of this. We will then have minimum quality standards when they are announced by the DWP which will add another layer of law. After that we then have our voluntary governance statement which will bridge the minimum standards and best practice. Above that we have master trust and other assurance frameworks that we're working on within the "educate and enable" space. At the very top of the pyramid is a section where, should you refuse to be educated and enabled then we will enforce.

One area that I know continues to concern many here is that of pension liberation. We appreciate that trustees and administrators can face a difficult balancing act. Trustees have a duty to carry out members' transfer requests where the legislative requirements are met. Many trustees feel they can only delay for so long due to the risk of complaints from members to the Pensions Ombudsman.

As I have said in the past we can only help to prevent this activity by joining forces with a number of agencies such as the FCA, HMRC, SFO, National Crime Agency, Action Fraud, City of London Police and DWP. It is through the concerted efforts of everyone that we can start to take a range of actions to curtail some of the culprits' undesirable activities. Action Fraud still remains the single point of contact if people need to report suspicions or concerns. Investigations are very much underway although because of the nature of these cases we are often unable to go into the details as much as we would like.

At the end of last year we held an industry summit to work through some of these challenges and discuss possible solutions. We will continue to work with industry stakeholders on next steps and possible responses.

Going forward we will be focusing on "strategic" cases but I would continue to urge everyone to be aware and vigilant. We have advice leaflets on our website and we are going to be launching an updated "scorpion" campaign later on in the year.

Well that is a brief tour of current DC issues that the regulator is involved with. Embedding the code is the key area of focus for this year and I think our code and guidance have produced a strong foundation for trustees, focussing them on putting in place a solid structure which will ensure good outcomes for their members.

Andrew Warwick-Thompson
Executive Director for DC, Governance and Administration, The Pensions Regulator
awarwick-thompson@thepensionsregulator.gov.uk
www.thepensionsregulator.gov.uk

Guide to OPDU Elite Policy wording

Pension Trustee Liability Insurance

Who is covered?

- Past, present and future trustees and employees
- A corporate trustee company
- The sponsoring employer company
- The pension scheme
- Lawful spouses, domestic and civil partners, estates, heirs or legal representatives of trustees or employees in the event of death, incapacity, insolvency or bankruptcy
- Any other natural person or entity acting as trustee as attached by specific written endorsement.

Who is included in the definition of trustee?

- Any natural person, including a director or officer of a corporate trustee company, who is or has been appointed as a trustee, including a constructive trustee
- The Policy also allows for any other natural person or entity, including a director or officer of that entity, to be specifically included by written endorsement.

Who is included in the definition of employee?

Any person providing services to the pension scheme whilst in the employment of the sponsoring employer company, the corporate trustee company, or the pension scheme, including:

- Directors and officers
- Committee and/or Board members
- Administrators
- Pension scheme managers
- Internal dispute managers.

What constitutes a claim?

- A written demand alleging a wrongful act (or, if no claim is being brought, the Trustee must become aware of the Wrongful Act during the policy period and must have been advised that a claim could be brought)
- A civil, ombudsman, arbitral proceeding or mediation
- A criminal prosecution
- An administrative or regulatory proceeding
- An official investigation
- A contribution notice as issued by the Pensions Regulator under the Pensions Act 2004
- An extradition proceeding.

What is covered?

The Policy will pay for loss resulting from a wrongful act, specifically on behalf of:

- The trustees or employees for loss which they are legally obligated to pay
- The sponsoring employer company or pension scheme for all loss resulting from indemnification
- The pension scheme for all loss which has been suffered as a result of exoneration
- The sponsoring employer company or corporate trustee company for all loss that they are legally obligated to pay.

What wrongful acts are covered?

The Policy offers protection against a comprehensive range of allegations, including:

- Breach of trust, duty or statutory provision
- Negligence
- Administrative errors
- Wrongful omissions
- Misstatements
- Misleading statements
- Maladministration
- Financial loss resulting from damage, loss or destruction of pension scheme documents.

What is included in the definition of loss?

- Damages
- Judgments
- Settlements
- Awards (including distress awards or compensation as determined by the various pension regulatory bodies)
- Defence costs
- Costs (up to a specified sub-limit) incurred in relation to a fact-finding investigation or proceeding (i.e. where there is not requirement for an allegation of a wrongful act) by the various pension regulatory bodies
- Costs (up to a specified sub-limit) for expenses incurred in taking action to prevent, limit or mitigate exposure to an actual or potential claim.

What is included in defence costs?

- All reasonable fees, costs and expenses that are incurred to defend or appeal a claim
- Provision for full advancement of defence costs
- Option to include the provision to incur emergency defence costs if required

Additional features of the Policy:

- The policy cannot be cancelled without the insured parties' agreement (other than in the case of non-payment of premium)
- A discovery period of 12 months is available should either the insurer or insured parties refuse to renew this policy
- Ability to apply different retention amounts depending on whether the deductible is to be paid by the sponsoring employer company or the pension scheme itself
- No deductible applies where exoneration has been granted or the loss is the personal liability of a trustee or employee
- Overall authority for the policy can be granted to either the sponsoring employer company or to the trustee(s), who then agree to act on behalf of each and every other insured party

The Policy also responds to a number of changing circumstances:

- Continuous cover for the remainder of the policy period in the event that the sponsoring employer company:
  - merges with or consolidates into another entity (any subsequent name changes to the sponsoring employer company and or pension scheme must be advised)
  - enters administration
  - commences wind-up of a pension scheme
- Automatic cover is granted for a new or additional pension scheme whose total assets are 10% or less of the combined total assets being covered (subject to endorsement). Schemes in excess of this have cover for a period of 60 days, after

which cover must be specifically agreed by the insurer
- Where a scheme has been wound up cover shall include those who were insured, or would have been insured, at the time for wrongful acts committed prior to the date of such cessation, with the potential to provide an extended period of cover of up to 15 years

Extensions included:

- Civil fines and penalties, where insurable
- Retirement cover: lifetime for named "Users" - During a pension scheme's membershipof OPDU, all retired trustees and administrators remain covered. If a pension scheme leaves membership, retired trustees and retired named administrators have insurance cover for their lifetime should no alternative cover already be provided. This gives individuals valuable peace of mind in their retirement when they no longer have any say in whether their pension fund should purchase insurance cover
- Costs (sub-limit £1m) incurred in relation to a fact-finding investigation or proceeding (i.e. where there is no requirement for an allegation of a wrongful act) by the various pension regulatory bodies
- Brand damage and reputation protection (sub-limit £100,000)
- Cover for extradition proceedings
- Prosecution costs
- Emergency costs provision (sub limit £100,000) where urgency dictates that OPDU or insurer's consent for incurring costs cannot be obtained
- Employee benefit programmes and/or employee share ownership programmes
- Costs incurred in replacing or restoring pension scheme documents in the event of their loss, damage or destruction (sublimit £100,000)
- Theft of pension scheme assets

Optional Extensions include:

- Court Application Costs (sub-limit as specified on request) - Sometimes issues arise where the trustees are advised to seek directions or a declaration from the court as to future conduct of matters or the interpretation of trust documents. Normally several interests have to be represented by separate lawyers and all parties costs have to be met out of the pension scheme's assets. The Court Application Costs Extension, reimburses costs ordered to be paid out of the pension scheme.
- Third Party Service Provider Pursuit cover for the purpose of establishing a breach of professional duty of care (sublimit £100,000).
- Any One Claim – This cover will convert the aggregate limit of liability under the policy to an Any One Claim basis.

Key Policy Exclusions:

- Fraud or dishonesty or intentional breach of law - Where established by judgment or other final adjudic ation or by formal written admission
- Personal profit or advantage
- Pollution - However defence costs included up to £1m for a claim brought
- Direct bodily injury or property damage
- Failure to fund / procure funds / collect contributions (save where this is a Wrongful Act of the Trustee)
- North American litigation. However, with OPDU's agreement, the exclusion shall not apply to North American litigation in respect of Wrongful Acts of the Insured undertaken outside the U.S. or Canada in respect of the Scheme which are governed exclusively by English Law.

OPDU Services

The Advisory Service

Provides trustees and administrators with general guidance and advice on matters affecting the day-to-day administration of the pension fund. It aims to facilitate good governance. The confidential advice line is staffed by lawyers and provides access to The Advisory Panel Experts where appropriate.

The Advisory Service is complementary to the services provided by members' existing professional advisers.

The Claims Service

Provides the best possible claims handling service through a team of in-house barristers, solicitors and pension professionals who deal with claims in sympathetic and professional manner. They are experienced in managing complex, sensitive disputes with due regard to the adverse publicity that litigation can attract.

Trustee Risk Management

Provides a risk-based approach enabling trustees to focus on the key risks requiring appropriate internal controls to comply with the latest legislation and regulation. Topical one-day seminars are held in conjunction with ACE European Group, The Pensions Regulator and other leading pension practitioners. TRM was established to achieve OPDU's aim of promoting good governance. Its services are available to all pension funds regardless of whether they are members of OPDU.

Other facilities:

OPDU can provide access to a number of other insurance facilities, for example: winding-up insurance; crime and fidelity insurance; cover for trustees following mergers, buy-out and protection against costs risks inherent in pursuing claims for damages against third parties such as fund managers and other service providers. If you have novel insurance requirements we can work with you to seek to develop a policy to meet your needs.

Members

www.opdu.com

A. Bilbrough & Co Ltd
Abacus Holdings Ltd
Adas Holdings Ltd
Admin Re UK Ltd
Advanced Technologies (Cambridge) Ltd
Aggregate Industries
Agility Logistics Ltd
Airbus Defence and Space Limited
Airflow Developments Ltd
Alfred Bagnall & Sons Ltd
Allied London Properties Management Ltd
American Embassy
Andrews & Partners Ltd
Antalis McNaughton Ltd
AP Racing Ltd
ARCO Ltd
Armstrong Group Pension Scheme
Arqiva Ltd
ASSA ABLOY Ltd
Assa Ltd Pension & Life Assurance Scheme
Association of British Travel Agents
AstraZeneca plc
Atos IT Services UK Ltd
Aveva Solution Ltd
Axiom Consulting Ltd
BAA plc
BAE SYSTEMS plc
BALPA
Bank of New York Mellon
Barnardo's
Battenfeld Gloucester Europe LTD
Beaufort Trust Corporation Ltd/Independent Pension Trustee Ltd
Bell & Clements Ltd
Besam Ltd
BG Group plc
Bhs Ltd
Bland Group UK Holdings Ltd
BNP Paribas Leasing Solutions Ltd
BNP Paribas London Branch
BNP Paribas Real Estate Advisory & Property Management UK Ltd
BOC Group Ltd
Bovis Homes Ltd
Box Clever Trustees Ltd
B&Q Ireland Ltd
Bradford & Bingley Plc
Brintons Ltd
Brit Group Services Ltd
Britax Childcare Group Ltd
British Airways Holidays Ltd
British Airways plc
British American Tobacco (Investments) Ltd
British Ceramic Research Ltd
British Energy plc
Britvic Soft Drinks Ltd
BTG International Ltd
Building & Engineering Services Association
Cable & Wireless
Camlab Ltd
Canada Life International Ltd
Cancer Research UK
Carillion plc
Carpetright plc
Catalent UK Swindon Zydis Ltd
CB Richard Ellis Ltd
Centrica plc
Charles Taylor Consulting plc
Charter Central Services Ltd
Church of Scotland
CN Group Ltd
Coats Holdings Ltd
Conservative & Unionist Agents
Continental UK Group Holdings Ltd
Coventry Building Society
Cumberland Building Society
Daily Mail & General Trust plc
Damovo UK Pension Plan
De La Rue plc
Dechert LLP
Dixons Group plc
Downlands Liability Management Ltd
Dr Martens Airwair Group Limited
DSSR
DT Assembly & Test-Europe Ltd
Du Bois Limited Retirement Benefits Scheme No.2
Dynacast International Ltd
East London Bus & Coach Company Ltd
E H Mundy Holdings Ltd
Eisai Europe Ltd
Electricity Pension Services Ltd
Electrolux plc
Energy Institute
EPC United Kingdom plc
Equiniti Ltd
Euler Hermes UK
Evonik Degussa UK Holdings Ltd
FirstGroup plc
Five Arrows Limited and Associated Companies Pension Scheme
Fives Landis Ltd
Fives Stein Ltd
FKI Ltd
Former Registered Dock Workers Pension Fund
Foster Yeoman Ltd
Furness Withy (Chartering) Ltd
FW Terminals Ltd
Gamleys Limited Pension and Life Assurance Scheme
Gartmore Investment Management Ltd
GB Ingredients Ltd
Getronics Pensions UK Ltd
Glass's Information Services Ltd
GMB
GNB Industrial Power (UK) Ltd
Goldschmidt UK Ltd
GSI Lumonics Ltd
Guinness Peat Group Plc
Hallmark Industries Pension Scheme
Hapag-Lloyd (UK) Ltd
Heating & Ventilating Contractors Association
HIBU (UK) Ltd
Highlands & Islands Airports Ltd
Highway Insurance Group plc
Hiscox plc
HMC Group plc
Honeywell Ltd
Honeywell UK Ltd
Honeywell UK Ltd (HIPS)
Howden Compressors Ltd
Howden Group Ltd
Husqvarna UK Ltd
Inchcape International Holdings Ltd
Inspec Fine Chemicals Ltd
Intercontinental Hotels Group plc
IPA Portable Pension Plan
Isola Werke UK Limited
J Sainsbury plc
Jabil Circuit UK Ltd
James Fisher & Sons plc
John Laing plc
Jones Lang LaSalle
Kingfisher plc
KLM Royal Dutch Airlines Ltd
Lafarge Tarmac
Landmarc Support Services Ltd
Lehman Brothers Pension Scheme
Leyland Bus Trustees Ltd
Life Assurance Holding Corporation
Lloyd's Register
Lookers plc
Lovells and Lovells Services
Lummus Consultants International Ltd.
Maersk Line (UK) Ltd
Maersk Oil North Sea UK Ltd
Mansell plc
Marlon Management Services Ltd
Martin & Son, Edinburgh Ltd
May Gurney Integrated Services plc
McGraw-Hill International (UK) Ltd
Merchant Investors Assurance Co. Ltd
Merchant Navy Officers Pension Plan
Merchant Taylors' Company
Merrill Lynch Europe Ltd
Midlands Co-operative Society Ltd
Miele Company Ltd
Miller Insurance Services Ltd
Milk Pension Fund Trustees Ltd
Mitchells & Butlers plc
Mitsubishi UFJ Trust & Banking Corporation
Moore Stephens LLP
Motability Defined Benefits Pension Scheme
Mouchel Parkman (UK) Ltd
Muntons plc
National Association of Clubs for Young People
National Grid plc
National Irish Bank
National Oilwell Varco UK Ltd
NCR Ltd
NDS Ltd
Neopost Ltd
NEST Corporation
Newman Labelling Systems Ltd
News International plc
NIAB Ltd
Norddeutsche Landesbank
North of England P&I Assoc Ltd
Northern Bank Ltd
Northern Executive Aviation Ltd
Novar Electrical Holdings Ltd
Novar Ltd
NOW: Pensions Trustee Ltd
Océ (UK) Ltd
Paymaster (1836) Ltd
P&O Ferries Division Holdings Ltd
P&O NedLloyd
P&O Steam Navigation Company
Panasonic System Networks Company (UK) Ltd
Parity Group plc
Pell Frischmann Consultants Ltd
Perivale-Gutermann Ltd
Philips Electronics (UK) Ltd
PNPF Trust Co Ltd
Portman Settled Estates Ltd
PricewaterhouseCoopers LLP – (DH&S)
PricewaterhouseCoopers LLP – (PwC Fund)
Protega Coatings Ltd
PWS Holdings plc
RAC plc
Radiocentre
Railways Pension Trustee Co Ltd
Rank Leisure Holdings plc
Rayovac Europe Ltd
Really Useful Theatres Group Ltd
Reliance Security Group plc
Renew Holdings plc
Rexam plc
Richard Irvin & Sons Ltd
Royal Air Force Benevolent Fund
Royal Institution of Great Britain
Saipem Ltd
Samsung Electronics UK Ltd
Sara Lee (UK) Holdings Ltd
SAUL Trustee Co
SCA Pension Trustees Ltd
Scipher plc
Scottish Enterprise
Scottish Power plc
Seatrans Shipping Services Ltd
Simmons Bedding Group plc
Six Continents Ltd
SMR Automotive Mirrors UK Ltd
Southampton Container Terminals Ltd
Southern Water Services Ltd
Spirent Communications plc
Standard Chartered Bank
Standard & Poor's Credit Market Services Europe Ltd
Steria Ltd
Stock Exchange Centralised Pension Fund
Stork Amsterdam International Limited Retirement Benefits Scheme
Sun Life Assurance Company of Canada UK Ltd
Sybase UK Ltd
Sygen International Ltd
Syngenta Ltd
Telent Ltd
TEW Engineering Pension & Life Assurance Scheme
T J Hughes Ltd
T G Lynes
Thames Power Services Ltd
The Arts Council of England
The Carpenters Company
The Chartered Society of Physiotherapy
The Dutton-Forshaw Group Ltd
The Fairtry Trawlermen's Pension Scheme
The Fishermen's Pension Scheme
The Fleetwood Fishermen's Pension Scheme
The Glenmorangie Company plc
The Goldsmiths Company
The Hull Fish Merchants Protection Association Pension Scheme
The Industrial Dwellings Society 1885 Ltd
The Institute of Marine Engineering Science & Technology
The IPA Portable Pension Plan
The Ironmongers' Company
The Joint Industry Board
The Law Society
The Leicester and County Convalescent Homes Society Pension Scheme
The Mayflower Corporation plc
The Oriental Club
The Pensions Trust
The Retail Motor Industry Federation Ltd
The Royal Households and The Privy Purse
The Royal Society
The Saddlers' Company
The Salters' Company
The Scottish Trawler Fishermen's Pension Scheme
The Shipowners Protection Ltd
The Stamford Group Retirement Benefits Scheme
The Steamship Insurance Management Services Ltd
Thermo Fisher Scientific Pension Scheme
Thomas Miller & Co Ltd
Thomson Directories Ltd
Tilbury Container Services Ltd
UBS AG
Ultra Electronics Ltd
Uniq plc
University and College Union
VA Tech TD (UK) Ltd
Vergo Retail Ltd
Volvo Group UK Ltd
V. Ships plc
W Mumford Ltd
Wales & West Utilities Ltd
Walkers Shortbread Ltd
Wardell Armstrong LLP
WATCO UK Ltd
West Ferry Printers Ltd
Whitbread Group plc
Whitecroft Lighting Ltd
WSP Management Services Ltd

OPDU

Occupational Pensions Defence Union Limited
90 Fenchurch Street
London EC3M 4ST
020 7204 2400

www.opdu.com

Members of **OPDU** have approximately **£210 billion** fund assets in trust with over **800** schemes insured

OPDU IS MANAGED BY **THOMAS MILLER**