SPENCE

Your Quarterly Pensions Update

Quarter 1 2021

April 2021

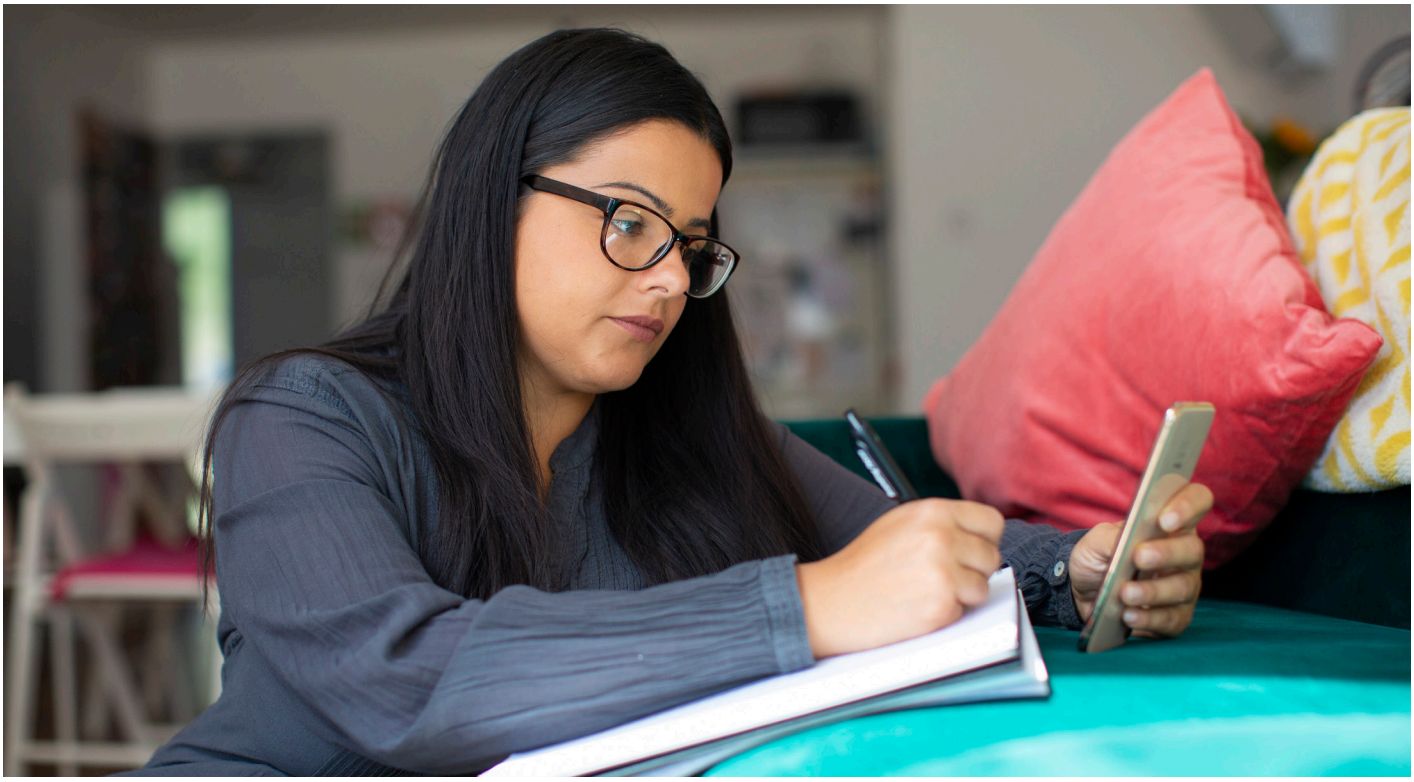
What's inside

Welcome to your Quarterly Pensions Update

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

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

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



Pension Schemes Act 2021 - Climate Change

Last year saw a number of schemes publish their first round of implementation statements and legislators have continued to push forward their agenda on Environment, Social and Governance (ESG) initiatives. Earlier this year the DWP published a guide on aligning pension schemes with the Taskforce on Climate-Related Financial Disclosures (TCFD) recommendations. At the same time, it consulted on proposals requiring schemes to address climate change risks. The Pension Schemes Act 2021 received Royal Assent in February and, when the responses of the consultation on climate change risk have been reviewed, the final regulations will be made under this Act, sometime this summer.

"The UK is set to become the first major economy to require climate risks to be specifically considered and then reported on by pension schemes. Together, we can build a better, safer and greener pensions system" - Guy Opperman, the Minister for Pensions.

The proposals will require TCFD disclosures to be published in the annual report as follows:

- From October 2021, schemes with £5bn or more assets, authorised master trusts and collective money purchase schemes.
- From October 2022, schemes with £1bn or more assets.

Insured annuity contracts are not considered relevant assets for the above purposes. Requirements for smaller schemes will be reviewed in 2024.

TPR has also published its Climate Change Strategy recently. David Fairs, TPR's Executive Director of Regulatory Policy, Analysis and Advice has said

"Our strategy outlines how we will help trustees comply with the new rules for larger schemes, but it signals work on climate change needs to happen right across the pensions landscape - climate change is a risk for schemes whatever the size or investment strategy. It is clear that all schemes need to build their capacity in this area if they haven't already."

All of the above publications are focused on climate change risk, but trustees should not forget about the other areas of ESG. DWP has launched a call for evidence on the Social element of ESG investing which *"seeks views on the effectiveness of occupational pension scheme trustees' current policies and practices in relation to social factors".*

Minister for Pensions Guy Opperman, launching the Call for Evidence, said

"I'm proud of the progress we have made in bringing environmental and climate issues up the pensions agenda, but climate change should not be trustees' sole consideration. Financially material social factors also pose risks to schemes' investments".

ACTIONS FOR TRUSTEES

- Is the scheme in scope of the draft regulations and, if so, when?
- Do the scheme trustees need training?
- What data will be needed?
- How will investment strategies, processes, monitoring and reporting change?
- What steps need to be taken to align with the TCFD recommendations?

Helpful Links

Aligning your pension scheme with the TCFD recommendations - GOV.UK

Taking action on climate risk - Response and Consultation on regulations - GOV.UK

Climate change strategy | The Pensions Regulator

Consideration of social risks and opportunities by occupational pension schemes - GOV.UK (www.gov.uk)

Pension Schemes Act 2021 'in practice'

What should trustees and employers be doing now?

Although the latest Pension Schemes Act only received Royal Assent in January (it was, in fact, the first Act of Parliament of 2021), it has been two years in the making and readers will already be familiar with the substantive provisions and are probably equally aware that implementation is dependent on regulations that are not expected to enter into force before October (or even later).

We have summarised the key changes in the Act in Quarterly Updates during 2020 and have, therefore, decided that subject to an aide-memoire at the end of this article, there is little utility in repeating them here, given that it will be around six months before they even start to take effect.

What we have done, however, is set out below our views on what trustees and employers can usefully do now in advance of the new requirements coming into full effect. Given the potential sanctions for non-compliance with some requirements, we make no apologies for the focus on 'education'.

WHAT SHOULD TRUSTEES AND EMPLOYERS BE DOING NOW?

New Powers for TPR: Contributions Notices

Actions for trustees

- Be prepared for employers being more likely to seek clearance for future transactions, including transactions before the new requirements become law, resulting in greater trustee involvement.

Actions for employers

- Keep the scheme's trustees informed of any proposed transactions that might impact the pension scheme; consider information sharing and confidentiality agreements with trustees.

New criminal penalties

Actions for trustees

- Update risk registers
- Consider training for the trustee board
- Have a standing agenda item to specifically consider whether any proposed actions at a trustee meeting might constitute "conduct risking accrued scheme benefits"
- Make sure scheme administrators have these new offences on their radar
- Check indemnities and insurance policies

Actions for employers

- Make sure that all officers/employees who take decisions on behalf of the company are aware of the new criminal offences
- Consider training for senior management
- Check directors and officers indemnity insurance
- Consider appointment of a professional trustee

Notifiable Events and accompanying Statement

Actions for trustees

- Become familiar with the new notifiable events regime
- Consider training
- Update the trustees' notifiable events framework
- Update risk registers
- Check insurance and indemnities

Actions for employers

- Make sure that all officers/employees who take decisions on behalf of the company are aware of the changes
- Consider training for senior management
- Check insurance policies

Inspection and Interview Powers

Actions for trustees and employers

- Consider appropriate training

Scheme Funding

Actions for trustees and employers

- Open a dialogue

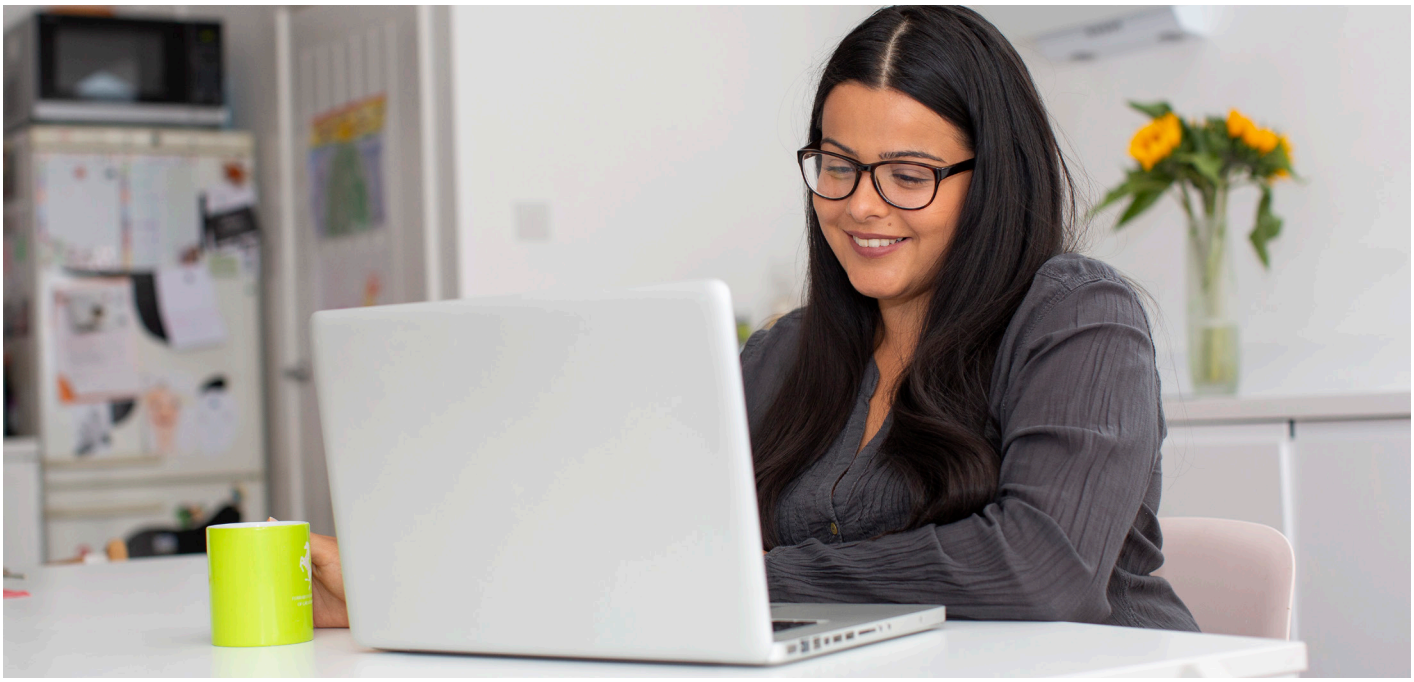
Climate Change

Actions for trustees

- Check whether the scheme will be in scope of the regulations
- Consider compliance as 'best practice' even if scheme not in scope
- Consider trustee training

Actions for Employers

- Find out what actions the trustees intend to take and consider alignment with the company's own measures



Dashboard

Actions for Trustees

- Consider putting in place a data management plan

Pension Schemes Act 2021: An 'aide-memoire'

Collective DC

- Legislative framework for new type of pension scheme design

TPR

- Five new criminal offences, in particular "behaviour that seeks to avoid s75 debt" and "conduct that puts accrued scheme benefits at risk"
- Up to seven years imprisonment and unlimited fines for criminal offences
- Separately TPR can impose fines of up to £1m
- Changes to notifiable events and requirement for declaration of intent regarding corporate transactions
- Two new contribution notice triggers – "act that materially reduces s75 debt" and "act that reduces employers resources relative to s75 debt"

Funding

- Legislative framework for new funding regime
- Act to be supplemented by regulations and new Funding Code (consultation in second half of 2021)
- Funding and investment strategy in written form ('chair statement' for DB schemes)
- Trustees need to think about long-term objective

Climate Change

- Public disclosure of a pension scheme's green credentials
- Detail in regulations – draft already issued for consultation
- Phased introduction {Big (>£1 billion) schemes first; smaller schemes likely to be in scope after review in 2023}

Transfer Values

- Changes to statutory transfer right where there are 'red flags'
- Regulations expected second half of 2021

Commencement

- Largely dependent on regulations

Helpful Links

Pension Schemes Act 2021 (legislation.gov.uk)

TPR consults on new criminal sanctions policy | The Pensions Regulator

Aligning your pension scheme with the TCFD recommendations - GOV.UK

Taking action on climate risk - Response and Consultation on regulations - GOV.UK

Investment Update

During the first quarter of 2021, global equity markets continued to post gains, climbing around 4%, as investor optimism increased. The pace and success of the vaccine rollout programs in the US and, particularly the UK, coupled with the confirmation of a $1.9 trillion fiscal stimulus package in the US, were the prime reasons for the increased optimism in the market. However, bond yields materially rose over the period (meaning prices fell) as expectations for improving economic growth and higher inflation put pressure on yields.

UK equities performed well over the quarter, up around 5%, as economic conditions improved. Sectors which previously underperformed due to the Covid-19 pandemic increased the most over the most recent quarter. Banks performed well due to better-than-expected earnings and the sharp increase in bond yields. Energy stocks also increased due to a rise in commodity prices.

US equities increased by approximately 5% over the quarter, driven by the Democrat's victory in the State of Georgia in January, which provided them with a (slim) majority in the US Senate and paved the way for a further US fiscal stimulus worth 9% of US GDP. President Biden also announced a $2 trillion infrastructure package, which he intends to pass later this year. Investor sentiment also rose as the unemployment rate declined by more than expected, while the Federal Reserve increased its growth outlook.

Emerging market equities finished the quarter higher, by about 1%, despite lower vaccination rates and increasing Covid-19 cases in countries such as Brazil and India. Chinese equities declined over the period, due to concerns about moderate policy tightening weighing on investor sentiment.

Investment grade corporate bonds posted losses in the first quarter of the year, as yields increased, while high-yield bonds had a small positive return as the risk appetite of investors increased in line with the improvement in economic conditions.

Government bond yields rose over the period (i.e. prices fell) with commonly held views that stronger growth and higher inflation expectations would force central banks to increase rates earlier than expected. For example, the 10-year US Treasury yield increased from 0.91% to 1.75% and the 10-year UK gilt yield increased from 0.23% to 0.93%.

Target End States

Targeting the End

Defined Benefit (DB) pension schemes are steadily maturing, meaning that many are shifting into cashflow negative mode. The endpoint has been crystallised and is generally much more tangible.

Until recently, there has been little guidance from The Pensions Regulator (TPR) in terms of what a scheme's ultimate destination should be, or how it should get progress to that destination. This will change, however, under the new Pension Schemes Act 2021, which introduces a requirement for trustees to set a Long Term Objective (LTO) and also have a plan for how they will get there.

With this as a backdrop, on 11 January 2021, a "Report of the target end-states for DB pension schemes" was presented to the Institute and Faculty of Actuaries (IFOA). This paper set out issues trustees, employers and their advisers should consider when addressing whether their Target End State (TES) should be low dependency, buyout or transfer to a superfund.

THE ROLE OF TRUSTEES, THE EMPLOYER AND THE ACTUARY

For trustees, it is acknowledged that the various duties and expectations on them means that they will generally operate in a relatively risk-averse manner. While recognising that covenant visibility is likely to be limited to the medium-term in most cases, the IFOA cautions against taking an unnecessarily low risk or no risk approach, if this is to the detriment of a scheme reaching its TES.

For sponsoring employers, the paper states that the employer has a key role to play in determining the TES for their scheme, the pace in which that destination is reached, and the actions taken in that journey. So, trustees and employers must understand the relative balance of key powers within their scheme rules.

For the actuary, it is envisaged that their future role, working with other advisers, will be pivotal in helping trustees to understand how to bring together the necessary funding, investment and covenant considerations.

CHOOSING BETWEEN THE TARGET END STATES

The paper concludes by setting out a five-step approach to determining the appropriate TES for a scheme as follows:

- Use a long-term Integrated Risk Management (IRM) framework to identify which of the trio of TES are in play and the Journey Plans that would get the scheme to those TES.
- Understand any requirements, constraints or other factors that may impact the choice of TES.
- Model for different Member Outcomes under the TES in play in the event of the employer default.
- Eliminate any TES or Journey Plans that are not desirable.
- Determine the preferred TES from those remaining, after which the Journey Plan can be refined and a plan of action developed.

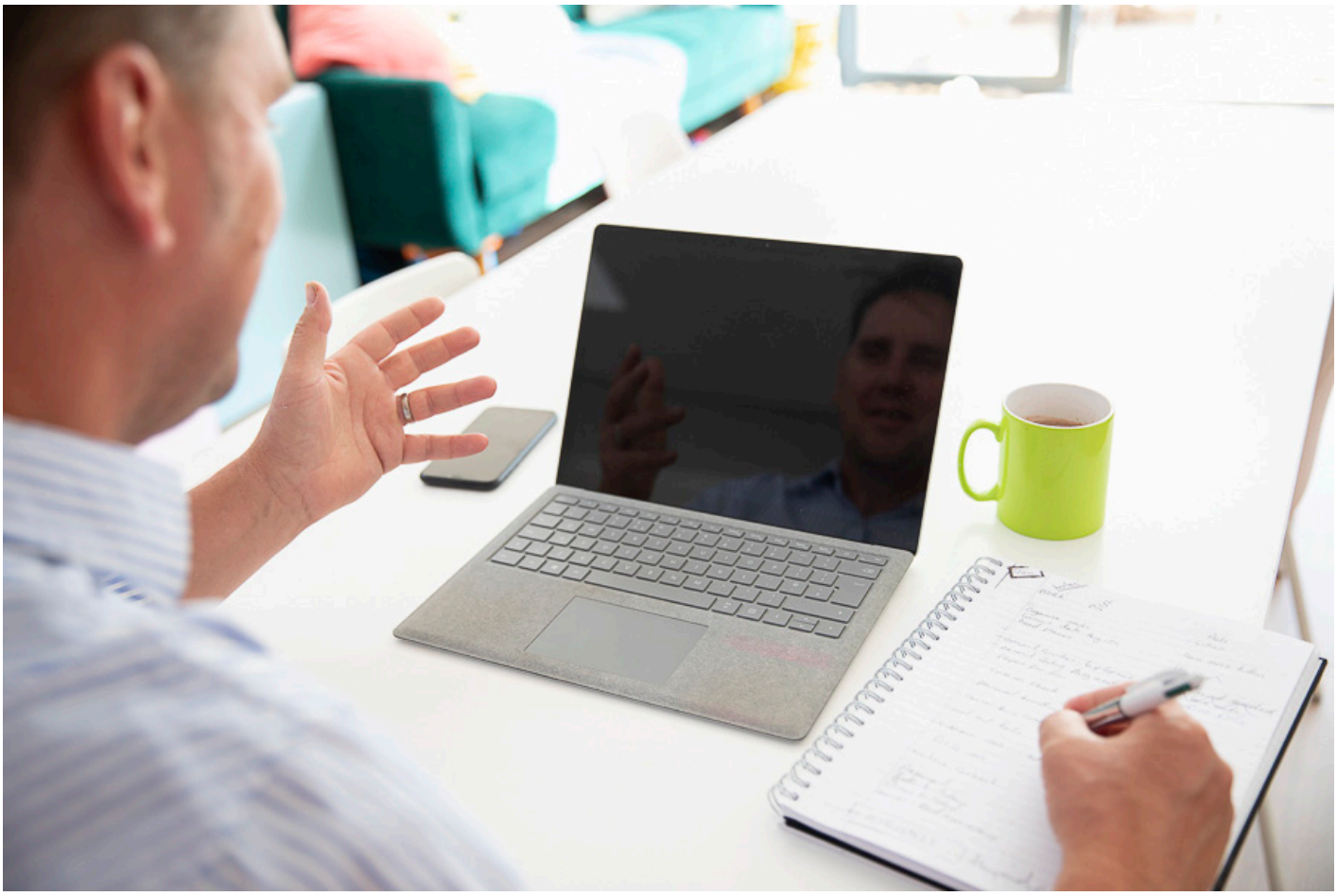
Once a TES is attained, this is not necessarily the end. Trustees should review their TES on a periodic basis to check it remains suitable and, as they get progressively closer to it, to decide whether that is where they will stop or whether it is the first milestone in a longer journey.

THREE KEY TAKEAWAYS

- **Think long-term.** The long-term objective of your scheme should be front and centre. Investment and funding strategies ought to work together to deliver the best member outcomes.
- **Be realistic.** For example, it can be unhelpful to focus on a TES strategy which has a primary objective of buy-out where that may not be affordable within a reasonable timeframe. Choose a sensible timeframe and review your TES periodically.
- **Have a back-up plan.** Having a plan is a great first step. Having a plan B, in case of employer distress, for example, is also sensible.

Helpful Links

End game and beyond Webinar



The Uber Case: Disrupting the Disrupter

A relatively new free market system that uses a slang word normally associated with musicians may not be as harmonious as it might first sound. Typically, the "gig economy" thrives to a large extent on temporary positions, where organisations hire independent, self-employed people for short-term commitments.

Uber is one such organisation operating in this free market system. It sees itself as a "disruptor" amongst the traditional taxi industry. This case was the culmination of a five-year legal battle that started in the Employment Tribunal (ET) and went all the way to the Court of Appeal. Uber said that its taxi drivers were not workers but self-employed, claiming it acted merely as a booking agent. The taxi drivers argued that they were "workers" under UK employment law. Establishing worker status is a prerequisite for a number of rights, including minimum wage, holiday pay, sick and pension benefits. The Supreme Court (SC) has now had the final word on the matter and has agreed with the taxi drivers, by unanimously upholding the Court of Appeal decision.

Broadly, the facts of the case were that Uber owns and operates a smartphone app through which customers order a private hire vehicle and pay the fare. Uber's position was that it is a technology platform facilitating the provision of transportation services; it does not provide those services itself. The transportation services are provided by the drivers. A contract is concluded between driver and passenger for each ride. The drivers were self-employed and Uber was merely a booking agent. All drivers had to have a private hire vehicle operator licence. Uber has complex contractual documentation purporting to create the above arrangements, although there is no written agreement between Uber and drivers. Any written terms between Uber and its drivers are entered into with UBV (Dutch Parent Company). The nub of the issue was that Uber had sought to define "worker" in their contracts so as to avoid the inconvenience of the definition of "worker" in the Employment Rights Act (ERA).

The matter was appealed each time by Uber until it reached the SC. The SC said that the contract was not the starting point to define who is a "worker". To do so would allow Uber to reinstate the mischief which the legislation was enacted to prevent. In other words, Uber cannot arrogate to itself the power of determining whether legislation designed to protect workers would apply to its drivers. The ERA deliberately provides a wide definition of "worker" because it aims to include as many people in that category as possible.

The SC unanimously dismissed the appeal and held that Uber is not a booking agent for drivers and that Uber drivers satisfy the definition of worker under the ERA. The SC identified several factors that undermined the fact that they were self-employed such as; working time starts when drivers log on the app, Uber sets the fares, the delivery of service does not allow the driver to build a customer base, and Uber decides on full or partial refunds. The true agreement is not gleaned from the specific contract but from all the other circumstances of the case, of which the written contract is only a part. Finally, the contract needs to take into account the purpose of the legislation.

ACTIONS FOR TRUSTEES

The SC judgment effectively signals the end of the road for bogus self-employment and has far reaching consequences for the gig economy. The implications are obvious for employers operating on similar business models. As workers under employment legislation, it is likely that the drivers would also be eligible jobholders under the Pensions Act 2008 and qualify for auto-enrolment, subject to the relevant age and earnings criteria.

The case will now be referred back to the ET to determine the merits of the claim and how to compensate the drivers. In the interim, Uber has announced it will give basic employment protections to its UK private hire drivers, meaning that some 70,000 drivers will have access to holiday pay and a pension scheme, as well as entitlement to be paid at least the national living wage.

Helpful Links

Uber BV and others (Appellants) v Aslam and others (Respondents) (supremecourt.uk)

PASA Guidance

Guidance note on tax issues

The Guaranteed Minimum Pension (GMP) equalisation working group, chaired by the Pension Administration Standards Association (PASA), has issued further 'good practice' guidance for UK pension schemes.

The latest Guidance highlights tax issues that schemes may encounter in adjusting benefits for GMP inequalities (GMPE) and identifies possible approaches for dealing with those issues.

The guidance contains 16 'key messages' and also includes examples; information on technical issues such as the various forms of HMRC protection and their interaction with GMPE; and template communications.

The guidance is light on the topic of GMPE and 'conversion', but there are too many 'known unknowns'; some of which it may only be possible to resolve through legislation.

Further guidance on conversion should be available by April or May.

Guidance note on Data Management Plans

PASA has launched its new Data Management Plan (DMP) Guidance in conjunction with PASA Expert Knowledge Provider for Data, Deloitte.

This Guidance sets out, at a high level, the purpose of a DMP and the information a DMP may be expected to include. It also covers the importance of data security.

It is becoming more and more critical for data to be complete and accurate for a scheme to meet all of its obligations, whether that be to pay members the right benefits at the right time, dashboard readiness, GMP equalisation, liability management exercises and eventual buy out of benefits.

A DMP is a critical scheme document and forms part of good scheme governance. Its implementation offers a means of documenting the data held by a pension scheme and a policy for managing it effectively. The information in the DMP should be integrated with the approach trustees are taking in respect of data as part of their wider risk management framework.

ACTIONS FOR TRUSTEES
Consider both guidance notes when equalising GMPs, and considering wider data and risk management requirements, respectively.

Helpful Links

https://www.pasa-uk.com/pasa-issues-gmp-equalisation-group-guidance-on-tax-issues/

https://www.pasa-uk.com/pasa-launches-data-management-plan-guidance/

What's happening in DC

Current and prospective developments for defined contribution schemes

AUTOMATIC ENROLMENT (EARNINGS TRIGGER AND QUALIFYING EARNINGS BAND) ORDER 2021

Under this statutory instrument, the upper end of the qualifying earnings band for automatic enrolment into a qualifying pension scheme will rise to £50,270 (from £50,000 last year) and the lower end of the band will remain at £6,240. No changes are made to the earnings trigger, which will remain fixed at £10,000.

Automatic Enrolment thresholds	Trigger	Qualifying earnings band, lower limit	Qualifying earnings band, upper limit
2020/21	£10,000	£6,240	£50,000
2021/22	£10,000	£6,240	£50,270

UBER DRIVERS ARE WORKERS NOT INDEPENDENT CONTRACTORS

The Supreme Court has held that an Uber driver is a 'worker' for the purposes of employment legislation, concluding that drivers are in a position of subordination and dependency in relation to Uber such that they have little or no ability to improve their economic position through professional or entrepreneurial skill.

Considering all the relevant factors together, the Court concluded that the drivers were 'workers' not self-employed.

This judgment could have significant implications for the gig economy; e.g. statutory minimum wage, pension auto-enrolment and holiday pay entitlements. Uber has confirmed that drivers will be enrolled into a pension scheme.

INCORPORATING PERFORMANCE FEES WITHIN THE CHARGE CAP: A CONSULTATION

This consultation document from the Department for Work and Pensions (DWP) is the next step to the DWP's earlier consultation 'Improving outcomes for members of defined contribution schemes'. The consultation includes:

- a Government response to Chapter 3 of the 'Improving outcomes for member of DC schemes' consultation ('diversification, performance fees and the default fund charge cap');
- regulations to introduce flexibility and innovation for DC schemes when they come to comply with the default arrangement charge cap;
- wider questions on the incorporation of private equity in a DC default arrangement and barriers thereto; and
- discussion on the issue of "look-through" in relation to charge-cap compliance.

The consultation was trailed in Budget 2021 and the clear policy intent can be gleaned from the ministerial foreword –

"I am bringing forward draft regulations, building on the policy proposed previously by the government, which would allow schemes to smooth the incurrence of performance fees, which are often payable on illiquid investments, over 5 years. The hope is that this will give trustees, especially those who might be unsure about investing in illiquid assets, greater confidence to make that leap, safe in the knowledge that they can deliver the best possible return for their members."

The intention is to introduce the changes from October 2021. Key points are summarised below.

GOVERNMENT RESPONSE TO THE PERFORMANCE FEE SECTION OF 'IMPROVING OUTCOMES' CONSULTATION

The 'Improving outcomes' consultation included a proposal to provide a prorated easement to performance fees and it has now been decided to move forward with this proposal.

The easement to the requirement to prorate performance fees when trustees come to assessing compliance with the charge cap will, in effect, see trustees able to remove the performance fee from the charge cap calculation when they need to prorate for those members that have either joined or left the scheme during the charges year. So, those members will only pay for the performance on the investment that they themselves have directly benefited from during the year.

The government also received a positive reaction to the idea of introducing the option of a multi-year rolling / averaging period to accommodate performance fees for the purpose of the charge cap calculation. In the latest consultation there are some illustrations to demonstrate how the smoothing approach could work.

According to the consultation, the government is not seeking to direct investment in any way – *"instead the role of government is to help facilitate innovative investment classes and the financial products available to schemes".*

A proposal for the exemption of physical asset costs from the charge cap was also supported.

PROPOSED CHANGES TO REGULATIONS

Given that the consensus emerging from the 'Improving outcomes' consultation was that introducing the option of smoothing performance fee payments over multiple years would reduce the risk of a charge cap breach and could increase investment in illiquid assets, the government is bringing forward regulations.

The latest consultation now focusses on a proposed change to regulations to permit trustees to take advantage of the option of a multi-year smoothing method for performance fees.

The policy intent is to supplement the two existing permitted methods for calculation of the scheme's charges regime with an option to include a 5-year moving average for performance fees, as an alternative to the in-year performance fees accrued. Illustrative examples have been developed to demonstrate how a multiple year smoothing approach would work in practice.

LOOK-THROUGH

The government has developed a position on look-through, which sits in statutory guidance on charge cap compliance (as a reminder, the charge cap for schemes used for automatic enrolment is currently 0.75%). It is now seeking views on its position, via a call for evidence, as to whether the current position acts as a significant barrier to investment in alternative asset classes, particularly venture capital and growth equity and, if so, what solutions should be considered. (The current position is that trustees of occupational DC pension schemes should 'look-through' any fund of funds or pooled investment vehicles, no matter the type of funds such vehicles invest in.)

Helpful Links

The Automatic Enrolment (Earnings Trigger and Qualifying Earnings Band) Order 2021 (legislation.gov.uk)

Uber BV and others (Appellants) v Aslam and others (Respondents) (bailii.org)

Incorporating performance fees within the charge cap - GOV.UK (www.gov.uk)

The charge cap: guidance for trustees and managers of occupational schemes - GOV.UK (www.gov.uk)

Pension Trustee Decision-Making

Overview

The Institute and Faculty of Actuaries has released research that it commissioned on the subject of Pension Trustee decision-making. In the foreword to the report, it is stated that it is the first extensive research programme on the decision-making processes of pension trustees.

The research provides an examination of the social and cultural context for decision-making within trustee boards and some key themes emerge from it, including the finding that behavioural biases appear to exist at the investor group level, and not just the individual level.

Against a backdrop of consolidation of trust-based arrangements, resulting in a reducing number of trustees being responsible for increasing monetary amounts of members' pension savings, the research is timely. It raises awareness of potential risks and provides practical suggestions of steps trustees can take to improve their decision-making.

While the research is focused on trustee decision-making, the findings may be equally relevant for anyone who is involved in decision-making in similar circumstances.

KEY FINDINGS

In addition to reviews of relevant research literature, this investigation into pension trustees' judgement and decision-making processes uses quantitative and qualitative methodologies.

The qualitative research examines the social and cultural context for decision-making within trustee boards, offering an understanding of the ways in which decision biases are formed. Key characteristics of trustee decision-making that are covered in the report are:

- **Group Decision-making:** Trustees make decisions as a group and potential biases can exist within that environment, which can often lead to poor outcomes.

  The report covers a number of factors in this context that can be regarded as sub-optimal. These are around the large amount of information presented to trustees and the resulting cognitive overload; the conduct of meetings, in particular consensus decision-making processes; the desire for consensus being strengthened by the relative homogeneity of trustee demographics; and the influential nature of the Chair of trustees.

- **Judge-Advisor Systems:** Advisors and consultants can be extremely influential in the decision-making process, thereby forming a judge-advisor system where trustees are the judges in their relationship with advisors. According to the research, *"Studies have shown that in general judges are significantly more receptive to paid advice…"*. The qualitative research finds evidence of trustees showing considerable deference to their advisors.

- **Surrogate Decision-making:** Trustees are, in effect, making surrogate decisions on behalf of members. This can potentially lead to deviations in normative financial decisions. One finding is that the overlap between trustees' and members' preferences and attitudes may be small - partly due to the difference in profile between the two groups, but also due to the homogeneity of the trustee group. The research suggests that trustees may favour more conservative and lower risk investment opportunities compared to members.

In the quantitative research, there is a focus on certain biases within decision-making and on understanding if they present themselves in trustee decisions. As an example, empirical results show that, when setting the acceptable level of pension replacement income, trustees project their own preferences instead of reflecting member preferences. So, trustees chose significantly higher pension replacement rates for members than members chose for themselves.

The research provides behavioural evidence that pension trustees are not immune from decision-making biases; and there is some variation across trustees in their susceptibility to decision biases, with less experienced trustees being more vulnerable.

Recommendations

Several recommendations are made for enhancing trustee decision-making in response to identified challenges.

- **Capacity and capability challenges:** Recommendations cover training, mentoring and raising awareness; the way on which information is presented; the structure/timing of meetings; guidelines for advisors and fund managers; and team activity and team leadership. With regard to member-nominated trustees, recommendations include increased use of professional trustees; more stringent selection processes; and, again, training and awareness of potential bias.
- **Risk biases:** Recommendations include making groups more heterogeneous; advice on preventing 'Groupthink' effects (e.g. by having a "devil's advocate" challenge thinking); reducing group size of trustees; and employing procedures that make certain tasks in group decision-making less susceptible to bias.
- **Board management:** A review of guidelines for the role and selection of Chair is recommended and anonymous feedback for the Chair from trustees and advisors.
- **Dealing with advisors:** Given the importance of third-party advisors to decisions made by trustee boards, a case is made for reviewing best practice in the selection of advisors and also the way their advice is considered.

Conclusion

While the report acknowledges the limitations of the research, it provides an interesting insight into trustee decision-making processes and how the quality of decisions may be improved. The findings and recommendations are worthy of consideration.

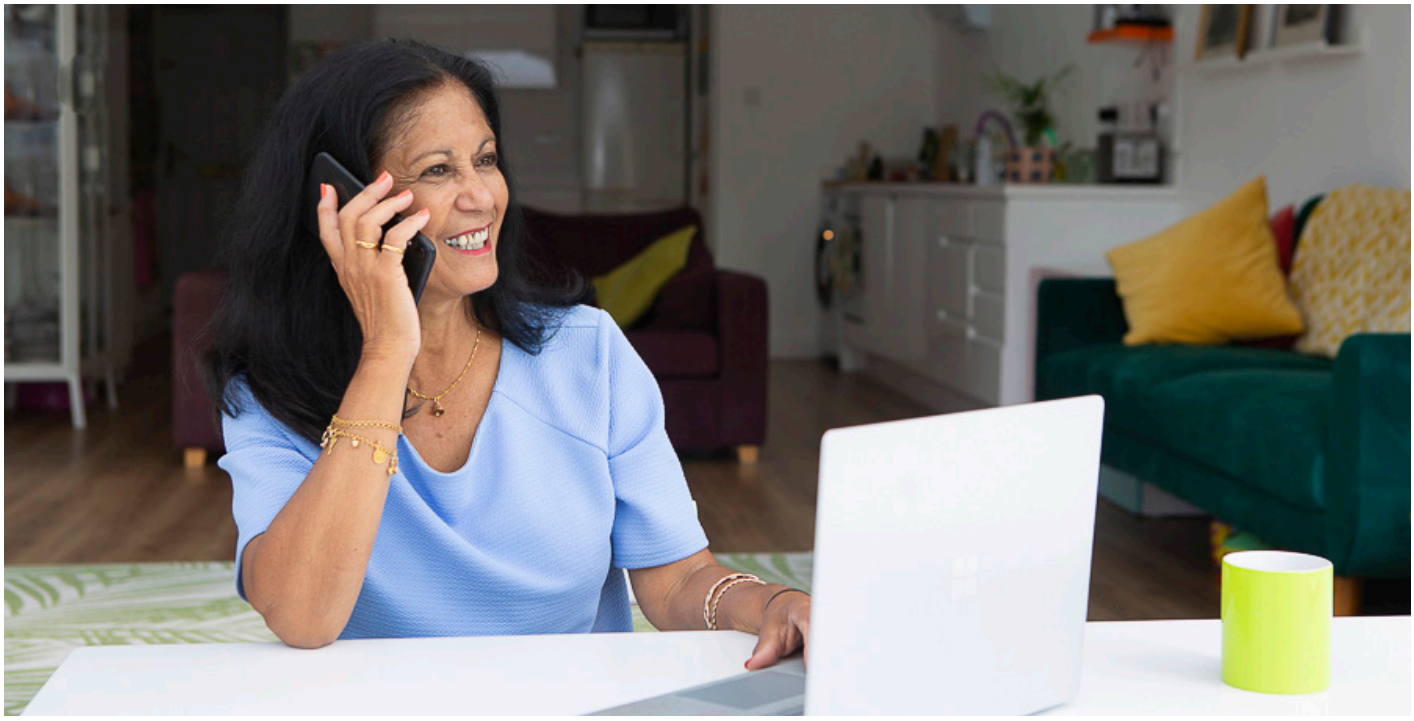
Actions

Trustees should consider the Report's findings in order to recognise the circumstances and biases that may be affecting the quality of their decision-making, and potentially implement the appropriate recommendations to improve quality.

Advisors should consider the points around their role in trustee decision-making and how they can play a part in improving the quality of decisions.

Helpful links

Pension Trustee Decision-making_Research Report IFOA



CMI 2021 Models

The Continuous Mortality Investigation ("CMI") - the group of actuaries who are tasked with carrying out analysis into mortality rates and trends in the UK - recently published its 2020 mortality improvement projections. These projections update the previous 2019 publication to take account of emerging mortality data in 2020.

The mortality experience observed over 2020 was significantly higher than that observed in previous years due to the impact of the Covid-19 pandemic. Therefore, mortality improvements would have been materially lowered if the CMI had simply updated their projections on a like-for-like basis. It remains unclear the extent to which the Covid-19 pandemic will impact future mortality experience. As a result, the CMI has added a new feature to enable users to reflect their view on the matter in the projections. Specifically, users can decide how much weight to assign to the mortality experience observed over the course of 2020. The default position in the projections is that no weight is placed on the 2020 mortality experience.

All else being equal, adoption of the 2020 projections will result in marginally lower life expectancies of scheme members. In particular, it found that life expectancies have fallen by around 0.1 of a year for males when compared with the 2019 projections, and that the change for females is negligible. As a result, adoption of the 2020 projections for mortality improvements should lead to a very minor decrease in a scheme's liabilities, when considered in isolation.

In its publication, the CMI urges users to consider making use of the three key inputs (namely, the "Period Smoothing Parameter", the "Initial Addition to Mortality Improvements" and the "Weight for 2020 data") to reflect their views in the projections and to ensure that the projections are appropriate for the membership characteristics of the scheme in question.

Trustees and companies should continue to engage in discussion with their actuary to explore the use of this latest mortality projection model and its impact on their scheme's funding position. If you would like further information on the impact of these inputs, please get in touch with your Spence representative.

Helpful Links

Link to Briefing Note produced by CMI - https://www.actuaries.org.uk/learn-and-develop/continuous-mortality-investigation/cmi-working-papers/mortality-projections/cmi-working-paper-147

Budget 2021

More savers caught in the lifetime allowance 'net'

Although the UK is beginning to emerge from our latest lockdown, government borrowing – the difference between public spending and income raised from taxes and other sources – will still reach a peacetime record in 2020/21. Before the Budget, forecasts anticipated that borrowing would reach between £350 billion and £400 billion. Also, even before new measures announced on 3 March, the Government's unprecedented financial support to public services, businesses and households came at a cost of around £280 billion. The sharp contraction in the economy in 2020 has meant significant falls in tax revenues.

It is within this context that the Chancellor delivered the Spring Budget 2021, unveiling a three-point plan to "protect jobs and strengthen public finances" –

1. Billions to support businesses and families through the pandemic
2. Investment-led recovery as UK emerges from lockdown
3. Future changes to strengthen public finances

Whilst the headline from the Budget was continuing support for those hardest hit (bringing total fiscal support to over £407 billion), key announcements from a pensions perspective were:

- Extension of the Coronavirus Job Retention Scheme (CJRS) for a further five months from May 2021 until the end of September 2021. Employees will continue to receive 80% of their current salary for hours not worked. There will be no employer contributions beyond National Insurance contributions (NICs) and pensions required in April, May and June. From July, the government will introduce an employer contribution towards the cost of unworked hours of 10% in July, 20% in August and 20% in September, as the economy reopens.

  This is relevant to trustees because the CJRS can impact the pensionable earnings upon which contributions and benefits are based.

- The government will maintain the Lifetime Allowance (LTA) at its current level of £1,073,100 until April 2026. In other words, more people could be impacted by the ceiling on tax relievable pension savings; especially those still lucky enough to have final salary pensions. Previous research suggests that the impact of the LTA has increased from circa 200 savers / £5m paid in tax to over 2,000 savers and £100m paid in tax between 2006 and 2018.

  The impact on revenue generated by the LTA change is shown in the table below.

EXCHEQUER IMPACT (£M)

2020 to 2021	2021 to 2022	2022 to 2023	2023 to 2024	2024 to 2025	2025 to 2026
-10	+80	+150	+215	+255	+300

No changes were announced to the Annual Allowance on pension 'inputs' nor, surprisingly, was there any mention of pension tax relief changes – not even for low earners in net pay schemes (although the outcome to a consultation on this issue is awaited).

- The national living wage will increase to £8.91 an hour from April. This can impact eligibility for automatic enrolment into workplace pensions.
- The rate of Corporation Tax will increase from 19% to 25% from 2023.

Also, the government is to consult on whether certain costs within the charge cap (currently set at a maximum of 75 basis points) affect pension schemes' ability to invest in a broader range of assets. This is to ensure pension schemes are not discouraged from such investments and are able to offer the highest possible returns for savers. DWP will also come forward with draft regulations to make it easier for schemes to take up such opportunities within the charge cap by smoothing certain performance fees over a multi-year period.

See 'What's happening in DC', above.

Climate change and pension schemes was not mentioned in the Budget but, on the same day, the Pensions Minister set out a timetable for regulations under the Pension Schemes Act 2021 which includes measures to ensure pensions are safer, better and 'greener'.

A useful 'what you need to know' factsheet on the budget has been published on GOV.UK, and full tax rates and thresholds for 2021/22 have now been published by HMRC.

The Finance Bill was published on 11 March.

From the perspective of pension scheme trustees, the Budget was, therefore, quite uneventful. They should, though, consider any impact of the extension of the CJRS on their pension schemes, might want to alert members to the freezing of the LTA (noting that some HMRC protections – Fixed and Individual Protection 2016 – are still available) and should look out for any changes affecting the charge cap and investments.

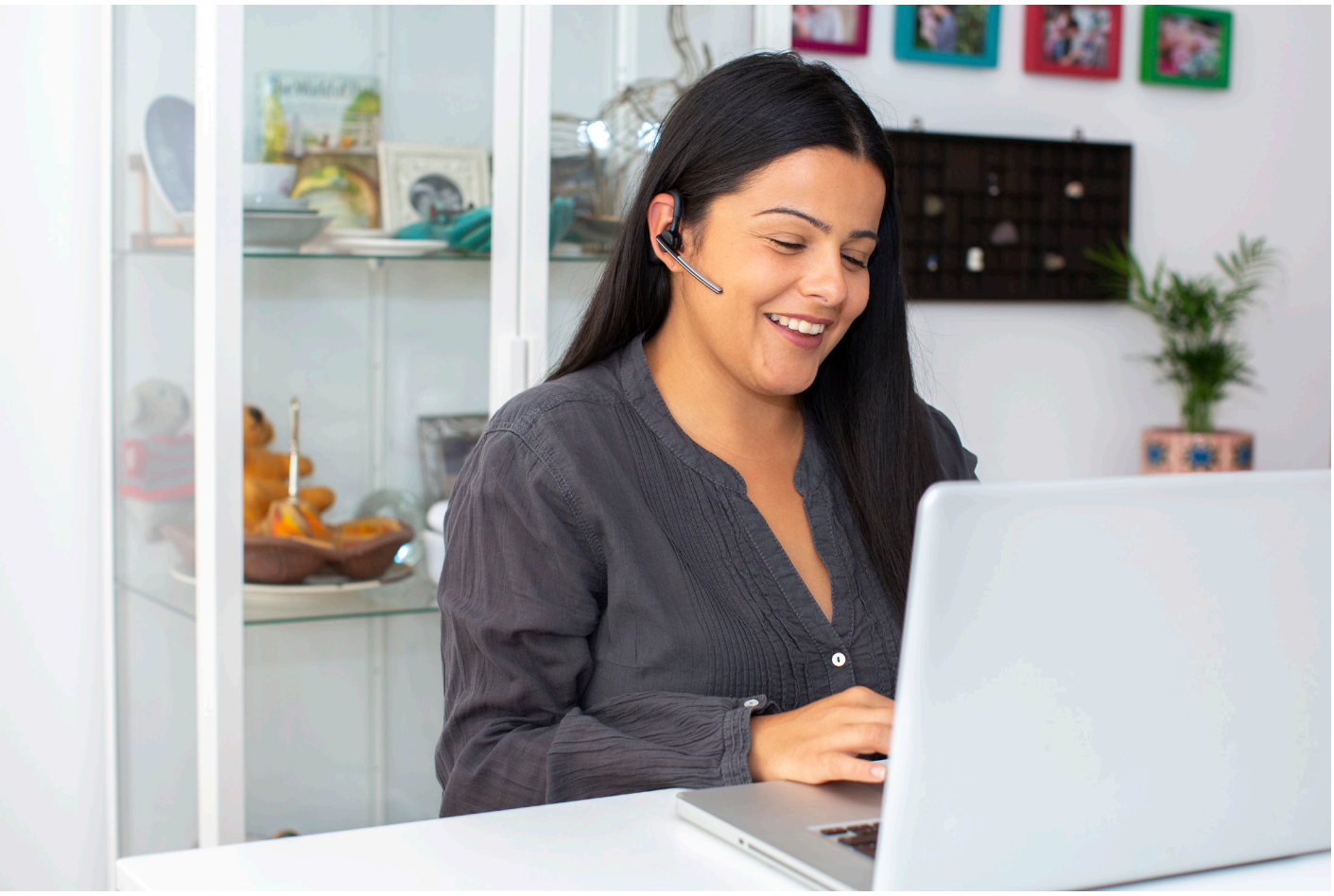
And a final thought. Will the increase to corporation tax influence the level or timing of employer contributions to company pension schemes?

Helpful links

Written statements - Written questions, answers and statements - UK Parliament

Budget 2021 - What you need to know - GOV.uk

Rates and Thresholds for Employers - 2021 to 2022 - GOV.UK



Coming up next...

In an effort to find some inspiration for this introduction, I found myself looking back to the opening paragraphs I penned for the first Coming Up Next article of 2020. Setting aside the obvious narcissistic issues of looking to oneself for inspiration, my article of a year ago, in the early days of the pandemic, began by lamenting the days when a lack of progress on pensions policies was due to Brexit, before commenting:

"Yet, despite the even more uncertain times we find ourselves in, it is important to remember that at the end of this pandemic – and there will be an end – we will still have pension scheme members, taxes, regulations and investments. So, let us continue to look forward, continue to plan, and continue to influence those things that we can control."

In a company-wide meeting today – made possible by our new, virtual working environment – we were reminded by a director of their prediction a year ago that we may not be returning to the office (or normality) for six months, or even one year. By their own admission, the suggestion of this lasting one year seemed pessimistic, if not close to far-fetched, at the time. However, here we are. Over a year later. Fast approaching eighteen months of this life changing event, with a return to "normality" quite possibly being on a two-year schedule.

Yet, thanks to the vaccine roll-out, that "end" alluded to a year ago is now starting to become tangible. Emerging from the haze and beginning to take some semblance of a form. As I type, I can see pictures of people (in England at least) queuing outside clothing stores, beside other images (of which I am infinitely more jealous) of patrons sitting outside pubs, enjoying a pint of their favourite beer (or any beer) in a real glass. The luxury.

Not – and indeed, never – forgetting that the last year has seen untold sorrow and hardship for so many, we are getting there, slowly but surely, tiptoeing towards normality. While our working patterns and processes may have changed, perhaps forever, our drive and focus has not and cannot change.

So, to echo my sentiment of a year ago, let us continue to look forward, continue to plan, and continue to influence those things that we can control, in this new normality.

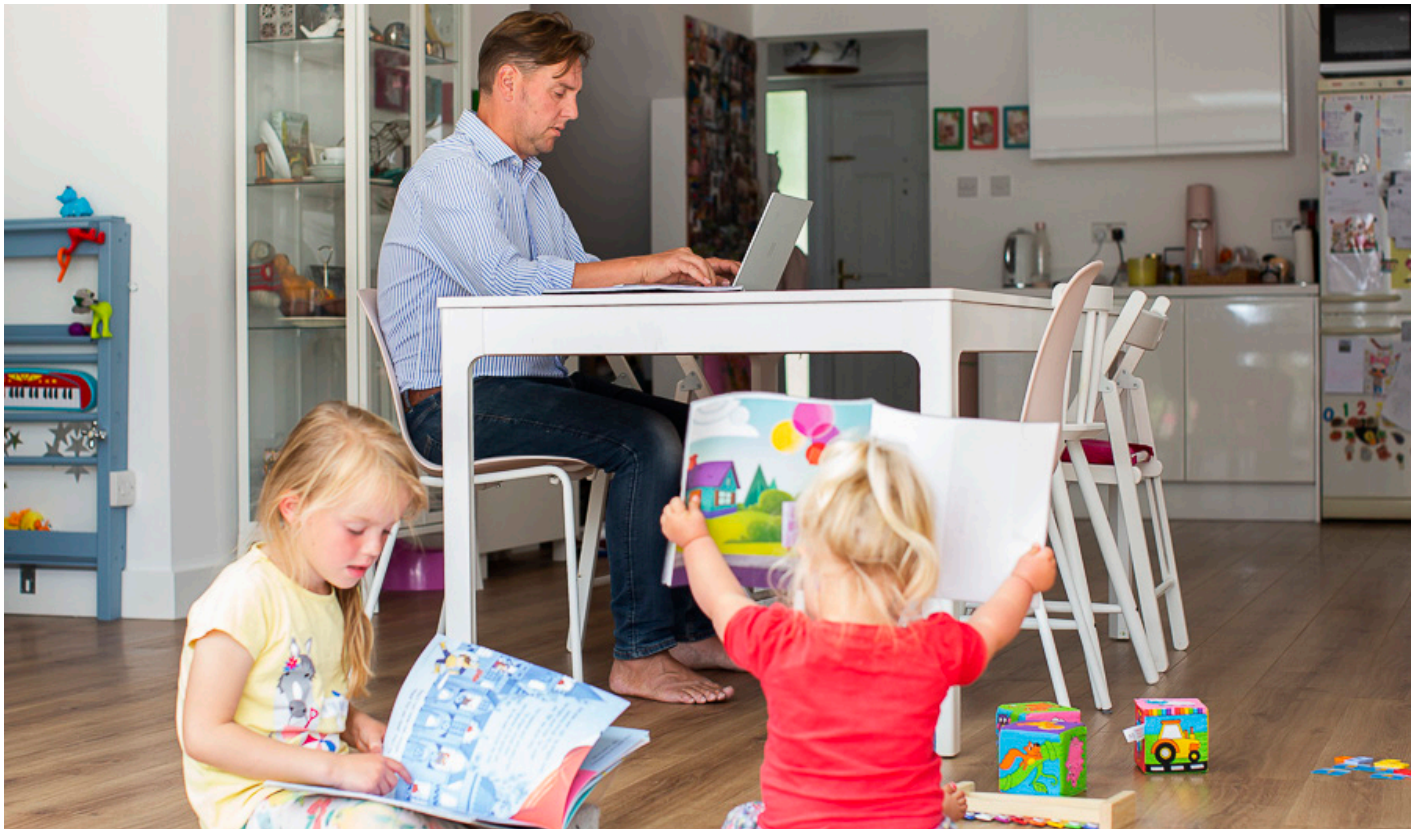
With that in mind, here are some of the events on the horizon that we believe are worth considering and will help sponsors and trustees alike in knowing what to do next.

- **TPR's Trustee Knowledge and Understanding ("TKU") Consultation** – in the first half of 2021 we expect to see the release of TPR's proposed updates to the Code of Practice on TKU and a request for feedback. A focus of the changes is likely to be how professional trustees are meeting the TKU standards and how this can be demonstrated through ongoing learning. While there have been no movements in the first quarter, we would be surprised if the second quarter of 2021 doesn't see TPR make an announcement.
- **Increase to the Normal Minimum Pension Age ("NMPA")** – The Treasury announced a consultation in regard to its proposals to increase the NMPA from 55 to 57 on 6 April 2028, alongside the proposal for a protected pension age regime. Towards the end of 2020 the government announced its intention to increase the NMPA as a reaction to the changes across society of increased longevity and working lifetimes of individuals. The proposals include protection for members of schemes who (as at 11 February 2021) have a right to take their pension at an age below 57, which includes any benefits yet to be accrued. The consultation is open to submissions until 22 April 2021, with the government expected to publish draft legislation in the summer.
- **Pension Scams** – We said in our last update that we expected 2021 to bring a much welcomed, and much needed, tougher stance on preventing scams. The first quarter of 2021 hasn't disappointed, with the revised Pension Scams Code of Practice from the Pension Scams Industry Group being launched just before Easter and an assortment of recommendations coming from the Work and Pensions Committee, following its inquiry into the impact of pension freedoms and scams. On the latter, of particular note were recommendations for Project Bloom to have a statutory footing, HMRC to review the imposition of tax charges on scam victims and social media/ tech firms to tackle paid-for advertising from scams on their platforms. There seems to be a real tail-wind behind this issue, so we hope to see real progress in the coming months to implement these much-needed reforms. Another step in the right direction is the announcement by the Pension Protection Fund (PPF) that it is raising a fraud compensation levy of 75p per member, or 30p for master trusts, in 2021/22.

The PPF said that it needed to raise the levy, the maximum allowed under current regulations, following a court ruling clarifying that occupational pension schemes set up as part of a scam were eligible to claim on the Fraud Compensation Fund. **Please refer to our Quarter 4 Report 2020.**

Trustees and sponsoring employers alike should also be aware of the following key dates in the coming months… (particularly if they are partial to a consultation or two!):

- **15 April 2021** – Closing date for DWP's call for evidence in relation to accessing pension savings (i.e. the second stage of the three-part inquiry).
- **16 April 2021** – Closing date for (another) DWP consultation, in relation to measures designed to allow DC schemes to smooth performance fees within the charge cap.
- **22 April 2021** – As discussed above, the Treasury's consultation seeking views on the proposed increase of the normal minimum pension closes.
- **22 April 2021** – Closing date for the consultation from TPR on its draft policy on the new criminal sanctions policy, as discussed in our earlier article on the Pension Schemes Act 2021.
- **29 April 2021** – Closing date for the DWP's consultation on changes to the contribution notice regime and TPR's information gathering powers, again, as discussed in our article on the Pension Schemes Act 2021.
- **4 May 2021** – Appeal of the decision of the High Court in Hughes v The Board of the PPF, on the PPF compensation cap, to be heard at the Court of Appeal.
- **13 May 2021** – Appeal of the decision of the High Court in Britvic Plc v Britvic Pensions Limited, on the measure of price inflation for pension increases, to be heard at the Court of Appeal.
- **26 May 2021** – Consultation period closes in relation to TPR's draft single code of practice relating to governance of schemes (to replace ten of the existing codes), as published in March 2021.
- **First Half of 2021** – A consultation is expected regarding an update of the TPR's code of practice on trustee knowledge and understanding.
- **30 June 2021** – The easement period for certain pension administrative processes by reason of the Covid-19 pandemic was extended to this date by HMRC.
- **30 September 2021** – The Coronavirus Job Retention Scheme is due to end, subject to any further extension by the Chancellor.



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