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60-second summary

Spring budget 2023 – impact on LGPS

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The Chancellor of the Exchequer, Jeremy Hunt, spelled out his Spring Budget plans on 15 March 2023. Highlights from a LGPS perspective were:

- an ambition for all “listed” assets to be pooled by March 2025, with a move to a smaller number of larger pools across England and Wales.
- more investment in illiquid assets as part of the Government’s levelling up agenda.
- the annual allowance will increase to £60,000 (and the money purchase annual allowance will rise to £10,000) from 6 April 2023, with the lifetime allowance being abolished altogether.

LGPS pooling

The Budget brought two updates with regards to Government’s future plans for pooling.

The first is a potential requirement for all funds to pool all “listed” assets by March 2025. This is a step-up in expectations from Government, who have not previously set strict deadlines. Key questions arise around the classification of “listed” assets. Is this simply traditional public equities and bonds, or will the definition be broader and include other assets that are sometimes classed as technically listed, such as property unit trusts? Another key question is with regards to passive funds. At the outset of pooling, many passive managers significantly cut their fees to provide LGPS-wide fee rates, given directly to the individual funds. This removed the need for funds to pool their assets together to negotiate lower fee deals with their passive managers. We now find ourselves in a position where transferring passive funds into a pool would increase management fees for funds, as they would then incur the pool’s fee on top. Careful thought needs to be given to this issue to prevent pooling actually increasing LGPS fund costs.

The second update is a potential move to a smaller number of larger pools. A huge amount is still unknown about Government’s expectations for this. One key issue is how this will happen. In the first round of pooling, funds were instructed to form 8 pools of at least £25bn in size and to work together to find their own solutions. Now that Government have seen a variety of operating models and results, will they be more prescriptive in how this consolidating of the pools takes place? Other important considerations are timescales for this to be completed by, as well as cost savings, given the significant expenditure the first round of pooling required.

Levelling up

Another update mentioned within the Budget was the potential for Government to require LGPS funds to invest in illiquid assets, such as venture and growth capital. This is something first specifically mentioned in the Edinburgh Reforms and is presumably a follow on from the "local investment" requirement mentioned in Michael Gove's levelling up white paper. Here, the ambition is for funds to invest money within the UK, in projects that will help the UK economy. Whilst these are asset classes that many LGPS funds invest in already, funds will need to carefully consider how they might invest whilst ensuring they can still expect to earn their required rate of return, for an acceptable level of risk. This balancing of fiduciary duty and support for the UK economy will be a challenge. Key questions remain on details of the types of investment which would fulfil this requirement; for example will there be a list of particular characteristics or a requirement to demonstrate the benefit this has on the UK economy, and whether any new requirement will include any investments already made by funds.

Changes to annual allowance and lifetime allowance

The increase to the annual allowance was broadly expected but the intention to completely remove the LTA took most people by surprise. We're currently awaiting more detail from Treasury on how the changes will work, but below we share our initial thoughts.

Annual allowance (AA)

The AA is set to increase to £60,000 from 6 April 2023. This will certainly remove a lot of people from a tax liability and will focus the AA on the most highly paid employees and those who experience significant growth in a single year. If carry forward rules stay the same, it will also allow members to build up more unused allowance with which to offset a breach, should one occur.

Given the changes to LGPS revaluation (which will see CARE benefits not increasing during the 2022/23 pension input period) and the future increase to the annual allowance, LGPS funds are likely to be sending out far fewer Pension Savings Statements in the next couple of years.

Lifetime allowance (LTA)

The Government appears to be tackling the LTA in two stages. The first stage is to abolish the annual allowance tax charge but retain a form of the LTA in the background. The LTA is a core pillar of the current pension tax system and is required in order to calculate things such as maximum lump sums and trivial commutations. Simply removing it would cause problems elsewhere, so for now schemes will be expected to continue asking retiring members for details of previous Benefit Crystallization Events and providing members with the percentage of LTA crystallized at retirement. The only difference being that a member who exceeds the LTA will no longer pay a tax charge.

This will give HMT time to comb the primary legislation and decide how they will remove the LTA with effect from April 2024. Whether this will be by replacing it with some sort of renamed notional LTA or with a more fundamental change to pension taxation (simplification part II?) remains to be seen.

If you've got any questions on anything covered in this 60-second summary, please get in touch with your usual Hymans Robertson consultant or contact Ian Colvin here.

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