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Kwasi-Budget makes waves

The new Chancellor of the Exchequer, Kwasi Kwarteng, presented a '*Growth Plan*' (described by many as a 'mini-Budget') to Parliament on 23 September 2022. In addition to tax cuts, it announced that the Government remains committed to exempting some performance fees from the defined contribution (DC) charge cap. The resultant, significant market disruption has particularly affected defined benefit (DB) schemes.

Productive finance—performance fee reform

The Government reconfirmed its intention to bring forward draft regulations to remove '*well-designed*' performance fees from the scope of the charge cap that applies to the default investment arrangements of DC occupational pensions schemes that are used for automatic enrolment. The hope is that this will give trustees '*the clarity and flexibility to invest in the UK's most innovative businesses and productive assets creating opportunities to deliver higher returns for savers*.'

The Government is also setting up a competition, the Long-Term Investment for Technology & Science (LIFTS), intended to provide up to £500 million to support new funds that encourage investment in UK science and technology businesses.

Tax cuts

The basic rate of tax will be reduced to 19 per cent from 6 April 2023, for income tax payers in England, Wales and Northern Ireland (the Scottish Parliament has devolved powers over income tax rates).[1] A one-year transitional period for 'relief at source' (RAS) schemes (mainly personal pensions) will allow them to continue to claim tax relief at the existing basic rate of 20 per cent.

The Government has abandoned plans to increase the rate of corporation tax from 19 per cent to 25 per cent in April 2023.

The 1.25 percentage points increase in the rates of National Insurance contributions (NICs) that took effect from April 2022, as a temporary source of funding for health and social care, will be reversed with effect from 6 November 2022. The new Health and Social Care Levy that was to have superseded the NICs rise in April 2023 will not now come into force.

[1] The 45 per cent additional tax rate was also to have been abolished, but the Chancellor appears to have rowed back on that policy.

OTS: on the scrapheap

The Government will eliminate the Office for Tax Simplification (OTS) and in its stead '*embed tax simplification into the institutions of government… and set a mandate to the Treasury and HMRC to focus on simplifying the tax code.*'

Aftermath

In an update issued subsequent to the '*Growth Plan*', the Treasury announced some of the next steps that the Chancellor will take:

- in October, he will 'outline regulatory reforms to ensure the UK's financial services sector remains globally competitive';
- on 23 November, he will set out his Medium-Term Fiscal Plan, alongside a full forecast from the Office for Budget Responsibility (OBR);
- there will be a Budget in the spring of 2023, together with a further OBR forecast.

Loss of confidence in Sterling prompted the sale of UK assets, pushing up gilt yields even further. Pension funds were forced to try to sell assets to meet additional, immediate margin calls on the derivative contracts that they were using for inflation-risk hedging. However, without investors willing to buy, the Bank of England has had to step in, announcing a temporary gilts-purchasing scheme, '*to restore orderly market conditions*'.

The Government's continued commitment to removing barriers to investment in illiquids is welcome. We believe that some illiquid assets can improve member outcomes at retirement and that, as schemes become larger, the more-traditional problems such as daily liquidity are less likely to be challenging. As with any investment, it will be critical to explore where these asset types can add most value for members over the course of their pensions journey and not to regard them as a panacea.

We are concerned, however, that, at a time of economic anxiety for many, the intricacies of the charge cap are a distraction from larger issues. Pensions savings may be the first thing to be cut for many, leading to an ever-increasing number of members headed toward pensioner poverty.

To maximise the tax-effectiveness of their pension contributions, some members may be in a position to make contributions before the available rates of relief are reduced. The increase in NICs that took place in April 2022 made salary sacrifice schemes more attractive, as the potential savings for employees were even greater; the Government's reversal will not go so far as to make such arrangements *un*attractive.

The announcements have resulted in increased market volatility and underperformance of UK assets. Whilst DB schemes in general will see improved funding levels, due to the effect of higher bond yields on discount rates, those with liability-driven investment solutions may need to re-examine their current liquidity arrangements.

PPF plans lower, simpler, more flexible levies

The Pension Protection Fund (PPF) has completed and published a Long Term Funding Strategy Review, and is consulting on proposals for its 2023/24 levies. Owing to its strong financial position and a reduction in the risks it faces, it expects that the levies will be substantially lower in future, and that it creates an opportunity to revise the levy methodology, to make it simpler, place more weight on underfunding and less on insolvency risk, increase the relative importance of the scheme-based levy, and differentiate between differently sized schemes.

The headline proposals for the 2023/24 levies are that—

- the levy estimate would be £200m (down from £390m in 2022/23);
- the increase from one levy band to the next would be halved, reducing the risk-based levy's sensitivity to changes in scheme sponsors' insolvency-risk scores;
- the risk-based levy scaling factor would be reduced by 23 per cent (from 0.48 to 0.37), and scheme-based levy multiplier reduced by 10 per cent (from 0.000021 to 0.000019);
- the risk-based levy cap would remain at 0.25 per cent of liabilities; and

- the '2022/23 adjustment' (which limited the potential increase over the previous year's levy) would not be repeated.

The PPF expects that its funding position will continue to improve, making it appropriate to *'significantly reduce'* levy rates in future. However, it wants the reassurance of being able to resume charging higher levies, if the need ever arises, as a safety net; this is likely to require Government support for legislation to amend the rules that constrain the PPF's discretion over changes in the levy from one year to the next.

Legislation also affects the ingredients and relative contributions of the risk-based and scheme-based components of the overall levy. As well as more flexibility over the amounts charged year-to-year, the PPF wants to be able to increase significantly the role of the scheme-based levy relative to the risk-based element, and to dial back the importance of employer insolvency risk in the calculation of the risk-based levy in favour of a greater emphasis on funding deficits. De-emphasizing insolvency risk is likely to come with a reduction in the number of levy bands.

The PPF would also like the flexibility to take a different approach to smaller schemes. This comes from a concern that schemes that (as the overall levy takings fall) will contribute negligible amounts and represent negligible risks may otherwise need to devote a disproportionate amount of their meagre resources to managing their levy bills.

The levy consultation exercise runs from 29 September to 10 November 2022.

Almost all schemes can look forward to lower levies for 2023/24, but a small number would have risk-based levy increases either because their 2022/23 levy was capped by the one-off adjustment for that year, or because of a significant worsening of sponsor insolvency scores.

Court rejects challenge to RPI reform

A High Court judge has dismissed an application, by the trustees of five large pension schemes, for judicial review of the UK Statistics Authority and Chancellor of the Exchequer's decisions about the future of the Retail Prices Index (RPI).[2] Unless there is a successful appeal—and we understand that that avenue may now be closed—it should be assumed that, in 2030, the RPI will become a clone of the CPIH (the Consumer Prices Index including owner occupiers' housing costs), and that no compensation will be paid to those disadvantaged by the change.

History

Indexed-linked gilts

Index-linked gilts (ILGs) were issued until July 2002 with a clause allowing early redemption if there is a *'fundamental change'* to the RPI that is '*materially detrimental'* to the holder's interests. The Chancellor of the Exchequer has a statutory power of veto over any '*fundamental change*' that would trigger early redemption. The last of those gilts matures in 2030.

From July 2002 to August 2005, ILGs provided for revaluation in line with the RPI, or a '*subsequent index*' that continued its function. To address concerns that the ambiguous phrasing of that provision might allow substitution of the RPI even if it continues to exist, ILGs from September 2005 onward say that a '*replacement Index*' can be used only if the RPI *ceases to be published*.

Disquiet

Misgivings about the methodological soundness of the RPI are a decade or so old. It lost its 'National Statistic' designation in 2013; an independent reviewer commissioned by the UKSA concluded, in 2015, that it is a '*flawed statistical measure of inflation*'; and in 2016 it was decided that the RPI should be retained for legacy purposes only, and that no more methodological improvements would be made to it.

In 2019, that policy of benign neglect was challenged by the House of Lords Economic Affairs Committee, which accused the UKSA of shirking its statutory duties by failing to fix the Index's flaws. The UKSA responded by proposing, in effect, to replace the RPI's innards with those of the CPIH.

The Chancellor of the Exchequer and the UKSA issued a joint consultation document in 2020, asking how (not whether) the RPI's internal workings should be switched with those of the CPIH, and whether the Chancellor should allow it to

[2] *BT Pension Scheme Trustees Limited and others v UK Statistics Authority and another* [2022] EWHC 2265 (Admin).

happen before 2030, when the UKSA can proceed unilaterally. Having considered the responses to the consultation, the Chancellor exercised his veto to prevent implementation of the change to the Index prior to 2030. The UKSA confirmed that it planned to proceed as soon as it was legally and practically able to, which it indicated could be in February 2030. The Chancellor said that no compensation would be paid to ILG holders.

As affairs stand, the RPI is treated officially as something like a *persona non grata*: the Office for National Statistics studiously avoids discussion of RPI trends in its monthly *Consumer Price Inflation* bulletins, generally mentioning it only to reiterate its shortcomings.

Judicial review

The trustees of five large pension funds with substantial index-linked liabilities and assets applied for judicial review of the decisions taken on the RPI, saying (in summary) that the UKSA and the Chancellor—

- proceeded on mistaken assumption that that the planned changes to the RPI were in accordance with the UKSA's statutory obligation to compile, maintain and publish the Index;
- failed properly to consider the interests of legacy users of the RPI, such as gilts holders and those with RPI-linked pension rights, thereby breaching the public-sector equality duty; and,
- had not gone about the business of consultation properly.

Judgment

The judge rejected all of the trustees' arguments. There was a logical obstacle to the claimants' case, in that the statutory framework explicitly caters for the possibility of *'fundamental change*' to the RPI (albeit making it subject to veto by the Chancellor); and they failed to persuade him that the UKSA's plan was something that transcended fundamental change and was impermissible.

The judge agreed with the UKSA that its responsibilities were confined to ensuring the quality of official statistics, and that the wider effects of the RPI decision on pension schemes and their members fell outside of its remit. The Chancellor was fully briefed on the issues, and did not fail to have regard to any material consideration; there was no basis for saying that his decision not to compensate gilt holders was legally flawed or irrational.

The judge's conclusion about the limited extent of the UKSA's statutory responsibilities undermined the trustees' contention that it had not consulted them, before reaching its RPI decision, about the consequences for them and their members. Nevertheless, he considered the various arguments in favour of a broader consultation duty, rejecting them all. The claimants failed to persuade him that the Chancellor was under a duty to consult on the payment of compensation, and in any event it was unclear what else they would have contributed in addition to *'the extensive and intelligent representations*' that they (and other '*legacy users*' of the RPI) had made in response to the joint UKSA – Government consultation.

For good measure, the judge also thought that any legal challenge should have been launched earlier, saying that the decision in principle to import the CPIH's workings into the RPI had been made in February 2019. Although it was somewhat academic given his other findings, he refused to grant the trustees an extension of time.

The trustees had an alternative, private-law challenge to the RPI decision, based on the clause built into ILGs from September 2005 onward, providing for use of a replacement index if the RPI ceases to be published. They argued that this 'cessation clause' is intended to protect ILG investors against changes that would affect the rate of return produced by the existing RPI link, and that it will therefore be triggered in 2030 when the RPI effectively becomes the CPIH in disguise. However, the judge had already concluded, earlier in his judgment, that the RPI would *not* cease to be published in 2030 (because the statutory framework allows for fundamental changes), so the Chancellor was entitled to a declaration that the cessation clause will not be triggered at that time.

This challenge to the UKSA's and Chancellor's RPI decisions felt, to borrow a phrase from American football, like a 'Hail Mary pass'. The unequivocal tone in which the challenge was dismissed tends to reinforce that impression. The judgment confirms that the UKSA can go ahead with its plans, and that no compensation will be forthcoming for those on the losing side; it seems like the markets, and the pensions world generally, had already acknowledged that as a *fait accompli*.

A productive month for the Pensions Regulator

Action plan to boost diversity and inclusion in trustee boards

The Pensions Regulator has produced an action plan on how it will help trustees to improve equality, diversity and inclusion (ED&I) on trustee boards. The plan says that the Regulator will provide trustees with clear expectations on diversity, and practical tools and information on how to satisfy those expectations.

The Regulator commits to—

- working with a Diversity and Inclusion Industry Working Group, that it established, to publish ED&I guidance for trustees and employers by April 2023;
- testing approaches and deciding on a mechanism for collecting diversity data that can be used to inform a baseline to measure progress by the end of 2024; and,
- continuing engagement and work with stakeholders and the regulated community to learn, build experience, and develop thinking to better support pension scheme governing bodies.

The action plan comes following research that showed that only 10 per cent of defined benefit (DB) and 14 per cent (DC) schemes were collecting trustee diversity information. Of those that did collect the information 40 per cent of DB schemes and 47 per cent of DC schemes had no plans to use it.

Warning to employers to comply with their AE duties

The Regulator issued a press release alongside its latest compliance and enforcement bulletin warning employers to ensure they are complying with their automatic enrolment (AE) duties. Recent, in-depth inspections of more than 20 large employers found several common technical errors in calculating pensions contributions and communicating with staff. The Regulator notes that such errors can often be a sign of broader compliance issues and that employers should take advantage of the triennial re-enrolment of employees to check their systems are up to date and '*running smoothly*'.

M&As: company directors must help pension trustees to protect savers

The Regulator also posted a new blog on its expectations in connection with mergers and acquisitions (M&As) involving scheme sponsors. It advances the now-familiar messages about the value of early engagement, the need for candour, and the goal that the pension scheme should be treated equitably in comparison with other stakeholders.

Climate-risk governance guidance updated

Lastly, the Regulator updated its climate-risk-governance guidance to incorporate material on the portfolio-alignment metric that will be required as 1 October 2022 (for scheme years ending after that date), for schemes with net assets of £1bn or more.

The perils of a 'head in the sand' approach to disputes

A recent Pensions Ombudsman's determination is a case study in why it is important to engage with his office to resolve member complaints.[3]

The complainant was enrolled into a pension scheme at the start of her employment, in 2018. In July 2020, it seems, the employer ceased paying any contributions to the scheme, despite continuing to deduct the employee's contributions from her wages.

The Ombudsman's determination in this case is remarkably brief, at four pages (and one of them is an appendix containing details of the missed contributions). This is no doubt attributable to the employer's failure to participate in the investigation, or even acknowledge any correspondence issued from the Ombudsman's office. In light of that, the Ombudsman's decision is based entirely on the complainant's account. He saw no reason to doubt the veracity of the payslips that she provided for the relevant period, so he directed the employer to make good the missing contributions and any shortfall in the investment units purchased as a consequence of the late payment.

The Ombudsman's decision diverged from the opinion of his adjudicator, who had provided an initial view of the case, on the question of the appropriate compensation for non-financial injustice (often described as 'distress and inconvenience').

[3] *Mrs G* (CAS-75166-S3Y9). A couple of subsequent determinations, *Mr L* (CAS-76801-H9Y9) and *Mr Y* (CAS-45488-D8T5), have similar narratives and outcomes.

Whilst the adjudicator thought that £500 was a fitting award, the Ombudsman increased that to £1,000 (thereby elevating it from 'significant' to 'serious' injustice, according to the Ombudsman's scale[4]). He said that the ongoing non-financial injustice suffered by the complainant has been *'exacerbated by its* [the employer's] *failure to respond during my Office's investigation*'.

The outcome of this case seemed inevitable, but shows that there is little to be gained and potentially money to be lost by simply ignoring the Ombudsman and hoping that he goes away. His reaction to the employer's non-engagement was predictable given the policy outlined in his redress guidance:

> '*Our awards for non-financial injustice are intended as an acknowledgement to the applicant of the inconvenience and/or distress that they have suffered. In other words, to remedy the injustice genuinely suffered – not to penalise or punish the respondent for bad behaviour. However, if a respondent persists in behaviour making it difficult for members to achieve redress and causing more anxiety, this is likely to result in a higher award.*'

The Ombudsman said that the employer's failure to pay over the contributions amounted to unjustified enrichment. It was almost certainly also a breach of its statutory obligations, but the circumstances of the case are so sparingly described that it is unclear which legislation would have applied. It may well be that the employer's details have been passed to the Pensions Regulator, so that this will not be the last that it hears about its compliance failures.[5] The timing of the initial contribution lapse (July 2020) may be a clue that it was prompted by pandemic-related financial difficulties.

Actuaries issue inflation risk-alert

The Institute and Faculty of Actuaries (IFoA) has issued a risk alert to its members to draw attention to the potential implications of the current high inflation environment to actuarial work. The alert prompts actuaries to carefully consider, and account for, the impact of current market conditions in their advice.

The alert forms part of a regular series of risk alerts to support IFoA members in delivering high quality actuarial advice, and to help protect the public interest. It sets out a number of considerations for all actuaries, including the importance of assessing the impact of the current high inflation environment on underlying calculation methodologies and expectations of future inflation. Specific considerations for actuaries operating within the fields of general insurance, pensions, and life insurance are also provided.

We welcome the IFoA's risk alert on high inflation given the current financial market volatility. With the Bank of England further raising interest rates by 0.5% to 2.25% in an attempt to combat soaring inflation and the publication, and resulting fall-out, from the 'mini-Budget', September has been a month of financial turmoil for many. It would be wise for Trustees to proactively consider the current and future potential impact of the current financial climate on their schemes. Areas of consideration could include monitoring the impact on scheme funding and current asset allocations, review and management of current Liability Driven Investment arrangements (LDI's), impact assessment on employer covenant, and review of current factors in place such as commutation and early/late retirement.

Please contact your actuary for further information and advice specific to your scheme before making any decisions.

[4] Factsheet: Redress for Non-financial Injustice *(September 2018).*

[5] The employer in Mr Y (CAS-4588-D8T5) has been referred to the Regulator for seemingly inducing its employees to opt out of automatic enrolment.

HMRC news: September 2022

Pension Schemes Newsletter 143 from *HIS* Majesty's Revenue and Customs contains articles on—

- the income-tax aspect of the Government's *Growth Plan*;
- relief at source;
- paying charges (scheme administrators should remember to cite the relevant charge reference; but if they do not have one, they can once again use the Pension Scheme Tax Reference); and
- event reports (HMRC has dropped plans for a new reportable event about annual allowance pension savings statements in public sector schemes; and does not expect to have the 2023/4 event report online via the Managing Pension Schemes service until the summer of 2023).

And Finally…

The Government has introduced to Parliament the *Retained EU Law (Revocation and Reform) Bill*, under which EU-derived laws and legal principles would expire* at the end of 2023, unless otherwise specified. Anything that's kept would be branded as '*assimilated law*' ('*We are the Borg. Your culture will adapt to service us. Resistance is futile.*')

**The actual verbs used to describe what will happen to the laws are* 'revoked'*, and* 'sunset'* (yes, as a verb). As euphemisms go, the latter seems a bit like the military use of* 'pacify'*.*

The Bill would also invert the legal hierarchy so that EU law no longer trumps UK law in the event of a conflict; and would allow the UK's higher courts to diverge from EU case-law precedents.

Identifying EU-derived laws and determining which ought to be 'assimilated' (perhaps in modified form, but probably without cybernetic implants) and what should be [washed/shovelled/allowed to f-f-f-fade] away might seem like cleaning the Augean stables in a day (an allusion that we employ not because we consider EU law to be a decades-old accretion of stinky cow poop, but because it was literally a Herculean labour). The Government has already, helpfully, published the results of an audit of legislation, in the form of the *Retained EU Law Dashboard*. If one filters it for DWP-sponsored legislation concerned with 'private pensions', one sees that there's a veritable shed-load of ~~sh~~ stuff that we work with that contains EU DNA (mutant, of course—always the best kind of DNA, story-wise).

How much of it we'd want to simply defenestrate is, of course, another matter. A more important focus might be on ensuring that things aren't inadvertently or clumsily expunged.

Anyone for a game of pensions-rules *Kerplunk*…?