PENSIONS & RETIREMENT

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ECONOMICS

Under pressure: the unwelcome return of inflation to the UK

Despite government assurances that it's a temporary blip, inflation is trending upwards. What are the implications for pension schemes and their members?

Stephanie Hawthorne

Inflation is an old foe, now almost forgotten in many countries. But should we be worried that it seems to be making a comeback in the UK?

In extreme cases, inflation has proved a nightmare. Germany, for instance, faced ruinous hyperinflation after the first world war, as it printed money to fund its onerous reparation payments. A loaf of bread that would have cost 160 marks in 1922 was priced at 200bn marks the following year. Destitute citizens ended up burning their worthless banknotes to keep warm.

No one is suggesting that any member state of the Organisation for Economic Co-operation and Development will suffer a similar fate today. Yet inflation has been ticking up. For instance, the average UK house price increased by 13.1% in the year to June 2021 to £266,000, according to the Office for National Statistics. That was the highest 12-month growth rate the market had seen since November 2004.

The consumer prices index (including owner-occupiers' housing costs) is also an area of concern, given that it rose by 3% in the year to August 2021, with the costs of food, fuel and second-hand cars all soaring. For context, that figure was six times August 2020's increase of 0.5%.

But how representative are these numbers? Inflation measures rely on consumption baskets of goods and services, while the statisticians have yet to catch up with pandemic-driven changes to our spending habits – for instance, less on travel and eating out; more on tech and home improvements. What's more, the spending profiles of an affluent suburbanite and a universal credit claimant are hard to average out.

Nonetheless, strong inflationary factors do exist. As the Covid crisis diminishes, a large amount of cash is waiting to be splashed, given that British savers have put away £220bn since February 2020. All of this surplus money, combined with supply shortages, will push up retail prices.

> **Inflation is the moth that eats away at your savings and income**

Indeed, the Bank of England projects that inflation will hit 4% by the end of this year, with other upward pressures including the phased ending of reduced VAT in the hospitality industry from the end of September, when it will rise from 5% to 12.5% until the end of March. Also in the pipeline is a £139 increase in Ofgem's cap on the price of gas in October, which will affect about 9 million customers.

The Bank believes that inflation will ease next year, yet worries persist. Some economists think that the quantitative easing programme – through which the Bank bought bonds worth £895bn as a response to the global financial crisis of 2008-09 – has already caused an asset price bubble in property and shares.

The pandemic has been an even greater economic shock, notes Alistair McQueen, head of savings and retirement at Aviva. He points out that the UK's GDP "fell by one-quarter in the opening months of 2020. In response, the government spent an extra £350bn."

In fact, public debt has reached a peace-time high of £2.2tn over the past 18 months – the equivalent of £80,000 for every household. One bright spot is that it has never been cheaper to borrow, thanks to historically low interest rates. But debts will eventually have to be repaid, or the UK could end up as another Weimar Republic. If inflation is still a concern next year, interest rates will need to rise.

Most defined-benefit pension schemes manage inflation risk by hedging, using a liability-driven investment strategy. Some schemes also focus on indirect inflation-hedging assets such as infrastructure and real-estate investments.

"If the current inflation scare becomes more pronounced, there will probably be more demand for portfolio protection in these forms," predicts Tappan Datta, head of asset allocation at Aon. "Even commodities might look appealing again. Pension funds have tended to avoid these in recent years on account of their relatively poor and very volatile path of returns."

Cash savings are poorly suited to fund retirement. Most accounts pay a mere 0.1% interest a year, or 10p on £100. According to Moneyfacts, not one standard savings account available today can outpace the rate of inflation. Last year, 91 deals could beat the then inflation rate of 1%.

Ian Burns, principal and actuary at pensions consultancy Buck, advises retirement savers to "contribute a percentage of salary rather than a fixed amount or a one-off contribution when combating inflation in pension fund savings. Your pension contributions will then increase in line with salary growth, which is likely to be higher than inflation over the full course of your career."

Equities are typically seen as the natural investment to generate real returns relative to inflation, he adds. The dividends provided by equities may also be attractive and could increase in line with inflation. The FTSE 100's dividend yield is currently about 3.4%, for instance.

"Investors need to be willing and able to invest for the long term – 10 to 15 years or more – and also need to be cognisant of market pricing at the point of investment," Burns says. "Investing a regular amount every month is very different from investing a large lump sum."

Retirees shouldn't leave too much cash in the bank beyond their needs for two or three years, he advises. That's because inflation can erode household budgets, particularly those of private-sector workers, who are rarely on index-linked defined-benefit schemes. Anyone lucky enough to have such a pension should usually see it rise each year, broadly in line with inflation.

For the rest, "inflation is the moth that eats away at your savings and income", says Andrew Tully, technical director at Canada Life. For the 7 million people on a fixed income in retirement, he warns that an inflation rate of 3% will cut their spending power in half in two decades.

Tully advises they use "some form of equity investment as part of a balanced portfolio. Using a combination of annuity and drawdown can give people the flexibility to bank a guaranteed income to pay the bills, while also leaving money invested to pay for life's little luxuries and help to protect against inflation."

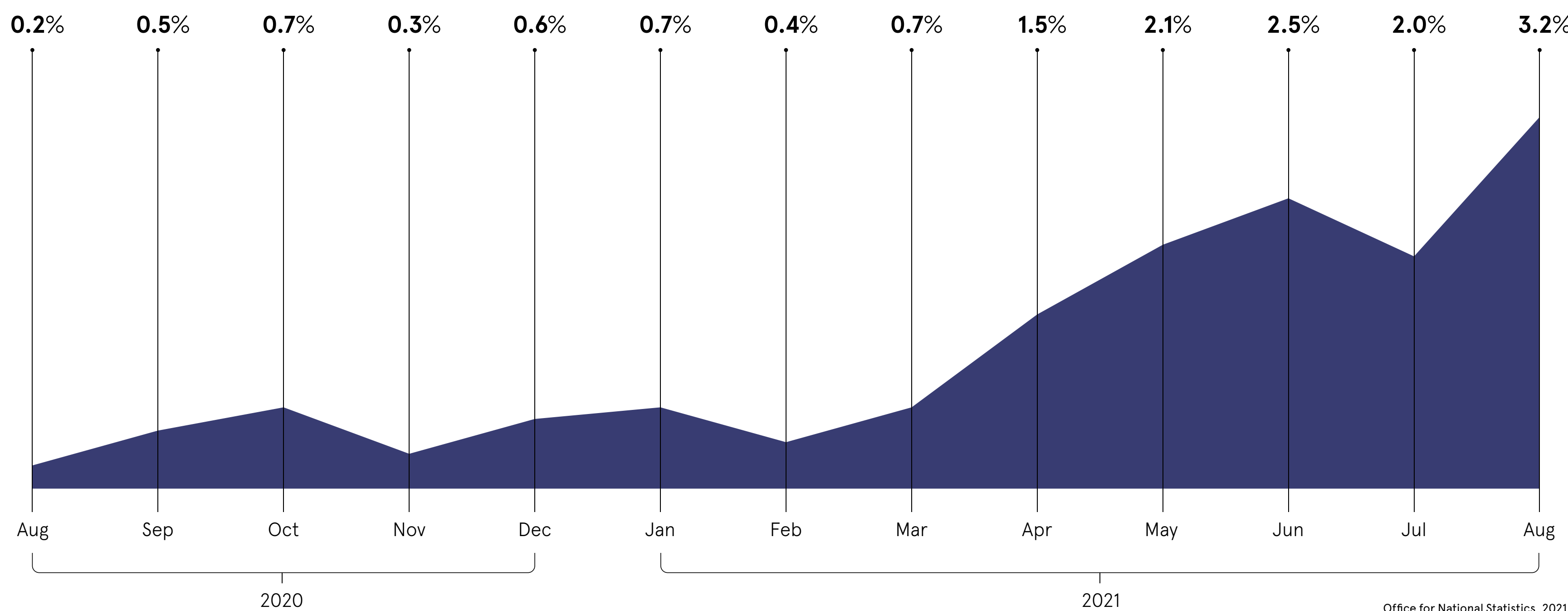
Lastly, one bulwark against inflation is the state pension, the bedrock of people's retirement income. This increases by 'the triple lock' – the highest of inflation, earnings and 2.5% – and at least keeps pace with inflation. But there are no guarantees.

"Rising price and wage inflation could add billions of pounds to the cost of the state pension," McQueen warns. "This has forced the government to step back for one year from its manifesto commitment to maintain the triple lock."

Be prepared to feel the squeeze. ●

INFLATION IS ON THE RISE, IF ONLY TEMPORARILY

Monthly consumer price inflation rates in the UK from August 2020 to August 2021



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Changing pensions landscape spurs data analytics revolution

Emerging risks and new investment strategies mean DB schemes need to have greater visibility and control over their pension plans

UK defined benefit pension schemes look very different now compared to even 10 years ago. The last decade has seen significant changes in regulation, investment strategy, and members' benefits, with schemes shutting to new entrants and future accrual. Many companies and schemes will now have a clear focus on an 'end game' where members' benefits are secured. While for the very largest this is probably still many years off, this change has spurred an evolution in management of pension schemes and a greater desire for technology solutions to support this.

"A decade ago, most pension plans were still heavily invested in equities, resulting in big short-term fluctuations in funding levels," says Simon Robinson, director of product management at Moody's Analytics. "Traditionally, schemes were largely dealt with by a pension manager, supported by consultants and asset managers, but this has evolved, with investment strategies changing substantially and in-house teams on both the company and scheme side increasing in size and expertise."

The landscape for pension scheme risk management has also dramatically changed over that time. For many, this has resulted in a much more closely managed risk position, perhaps looking more like an insurer's annuity book. For example, one trend is for schemes to follow a cashflow driven investment (CDI) strategy where schemes look to closely match expected liability payments with cash flows from the assets held. This shifts the risk management approach towards a much greater focus on the default risk of the assets.

"The risks pension schemes face have migrated from big swings in equity markets to less likely but big impact risks like defaults, or more complex and subtler ones such as when asset cash flows are received, for example," says Robinson.

> **New risks and considerations for pension schemes are constantly emerging**

New risks and considerations for pension schemes are constantly emerging. For instance, the introduction of freedom and choice pension reforms has increased the uncertainty for schemes of how and when members will take benefits. Environmental, social and governance (ESG) risks add layers of complexity, underscoring how the nature of risks will continue to evolve in the future.

"Schemes are monitoring cash flow needs on a very regular basis. You don't want to be a forced seller of assets because you've not planned well enough," says Robinson.

Sophisticated pension schemes are also taking a more holistic view of how their schemes would respond to different risk events. By focusing on a broader range of risk measures, they are ensuring their schemes are less likely to be impacted by any unexpected risks that emerge.

"There is an increasing demand on trustees in terms of both managing data and risks and being seen to manage them. Smart technology is now an essential part of how schemes achieve this," says Robinson.

Many schemes are also seeking visibility across their entire portfolios. For instance, a scheme might have as many as 30 or 40 different asset managers, and while those individual asset managers may disclose information about their fund, schemes need to have an aggregate view to ensure they gain more insight into what is going on at a broader level. This enhanced picture means they can better spot concentration risks at a portfolio level or, with the growing focus on ESG and climate risk, allow companies to see if they have any unwanted off-balance sheet exposures that they don't know about.

"Large schemes are currently collecting carbon emissions data from all of their asset managers with the challenge of both aggregating it and dealing with inconsistencies," says Robinson. "Managing assets against liabilities is well established now but the approach needs to encompass new considerations consistently. Ultimately, if you don't have an overarching entity-wide view of the pension scheme, both in terms of assets and liabilities, there are a number of ways you can get tripped up."

> **Central sources of data and analytics provide control and can help facilitate this new model of working**

Against this backdrop, some pension schemes are changing the way they approach resourcing, too. Where schemes typically follow a more consultant-driven model, larger schemes have scaled up internal capabilities both in terms of in-house company teams and pension scheme executives on the trustee side. One benefit of having larger internal teams is that schemes can use external consultants effectively and efficiently in areas such as idea generation, solving challenges, reviews, or helping to scale up resources for larger projects, rather than for low-value work that can easily be handled in-house, for instance. Central sources of data and analytics provide control and can help facilitate this new model of working.

> **There is an increasing demand on trustees in terms of both managing data and risks and being seen to manage them. Smart technology is now an essential part of how schemes achieve this**

Companies and trustees of large schemes have recognised the importance of having a greater ownership of the operation of their schemes, which can run to a balance sheet of billions of pounds. In-house expertise that has access to data and analytics means schemes have oversight of the information they need, when they need it, without being beholden to any one third party.

"It's all about effective management of a large, complex financial entity," Robinson says.

The change in governance structures and growth in pension scheme personnel over the past decade has created an opportunity for the most forward-thinking schemes to embrace holistic analytics tools, to give them greater control over their data and more effectively manage their schemes – enabling better decisions and achieving better outcomes for all stakeholders.

For more information please visit pfaroe.moodysanalytics.com

MOODY'S ANALYTICS

Oscar Wong via Getty Images

SUSTAINABILITY

Pension providers sharpen their focus on ESG as rules evolve

A new climate-related disclosure framework should spur more ESG investments by pension schemes, future-proofing their portfolios against environmental risks

Ben Edwards

From record rainfall and flooding in New York to devastating wildfires in Turkey, the consequences of inaction with regard to tackling climate change are impossible to ignore. For pension schemes, a new regulatory regime that addresses this issue is on the horizon.

From October, a host of occupational schemes in the UK will have to comply with a reporting framework developed by the Task Force on Climate-Related Financial Disclosures (TCFD). Under it, they must keep scheme members informed about the extent to which their pensions are being exposed to climate risks and how investee companies are being held to account for reducing their carbon emissions.

Although the TCFD framework initially applies mostly to defined-benefit schemes with more than £5bn of assets under management, it will also cover funds that are under a master trust arrangement. This affects a number of defined-contribution (DC) schemes that are significantly smaller than £5bn, says Jennifer O'Neill, a responsible investment consultant at Aon.

"There's a lot that needs to happen to make those disclosures in terms of building the reporting structure and the governance that sits around it, determining the strategy and looking at the effectiveness of risk management. That all has to happen before the pension fund is in a position to make a disclosure," she says. "This makes an awful lot of work for pension scheme trustees and other decision-makers, for which they'll need support."

For smaller schemes with fewer resources, complying with the new rules is likely to be a challenge, according to François Barker, a partner and head of pensions at law firm Eversheds Sutherland.

"The costs are quite onerous," he says. "The bigger schemes have more in-house resources and bigger budgets for bringing in external advisers, so there is no doubt that the larger providers are much better placed to handle this."

The TCFD requirements focus on the reporting process rather than prescribing how schemes should invest their members' savings, but Barker believes that the onus on fund managers to disclose more information to members is likely to influence their investment decisions.

"We're already finding with some of the bigger schemes that groups of members are getting together and challenging them for failing to do enough about climate change. When they have to start publishing this information, that will give much more ammunition to those groups, as well as to third parties that also want to challenge pension funds to do more," he says.

> **Pension schemes' adaptation to climate change is not an optional extra. All pension providers have a crucial role to play in getting the UK to net zero**

This increasing focus on climate risks and wider environmental, social and governance (ESG) considerations could also create additional challenges for pension scheme trustees as they try to balance their expanding ESG commitments with other fiduciary duties.

There is a "slight risk" to trustees and fund managers that, as they devote more attention to ESG concerns, "they could potentially drop the ball somewhere else". Barker says. "If your ESG policy causes you to sell an asset that then happens to outperform, you need to be able to justify what you've done in the round, rather than just defending it as a good ESG decision."

Rita Butler-Jones is joint head of DC pension sales at Legal & General Investment Management. She believes that the TCFD framework is ultimately about galvanising change across the investment chain – from asset owners and managers to the investee companies – by allocating capital to enterprises that are doing the most to reduce their carbon footprints, as well as future-proofing pension portfolios and helping to build more resilient societies.

"There's definitely evidence to show that disclosure requirements can accelerate the deployment of more green investments," she says. "Pension schemes' adaptation to climate change is not an optional extra. All providers have a crucial role to play in getting the UK to net zero. Pension schemes that are shunning ESG are at risk of incurring fines, legal challenges, irreparable reputation damage and potential investment losses."

Butler-Jones says that her company has encouraged firms to be more open about their climate impacts and their strategies to cut emissions, while sanctioning those that fail to meet their targets.

While the main focus so far has been on climate-related investing – the 'E' in ESG – O'Neill says the social aspect is increasing in importance too. Indeed, socioeconomic inequality is the second-most pressing issue on fund investors' minds, according to a recent survey by Aon. Butler-Jones reports that there is also an increasing interest in issues such as the gender pay gap and the lack of boardroom diversity.

"Climate has been at the forefront of peoples' minds, but 'S' and 'G' are really coming to life now in terms of how people are rating their importance," she says.

While the focus on reducing carbon emissions and ESG investment in general can benefit society at large, it also has the potential to deliver better outcomes for pension holders.

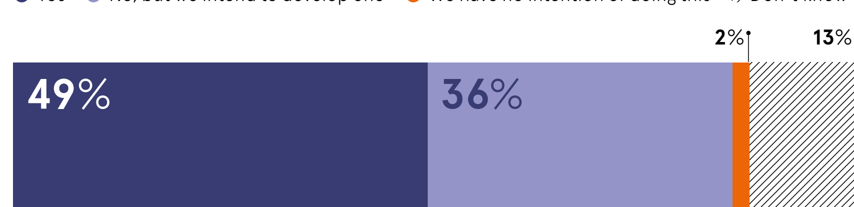
"Members are why we're here – and that should be at the forefront of our minds," O'Neill says. "Better investment decision-making has a positive effect on pension outcomes for our scheme members. And better decision-making has to include responsible investment."

Consumers' increasing preoccupation with climate change and the wider public discourse about global warming are also encouraging scheme members to take more interest in ESG matters and, by extension, their overall pension plans.

"It has always been challenging for us to engage members in their savings, especially in the DC space. But what we are finding now is that ESG seems to be the magic key that's helping people to engage with their pensions and consider their investments more broadly," Butler-Jones says. "For them, it's not only about asking: 'Is my fund ESG?' It's also about asking: 'Am I saving enough?' So this has had a beneficial indirect impact on engagement in the DC pensions world."

PENSION FUNDS ARE GETTING ETHICAL

Share of pension funds with an ESG policy worldwide



HSBC, 2020

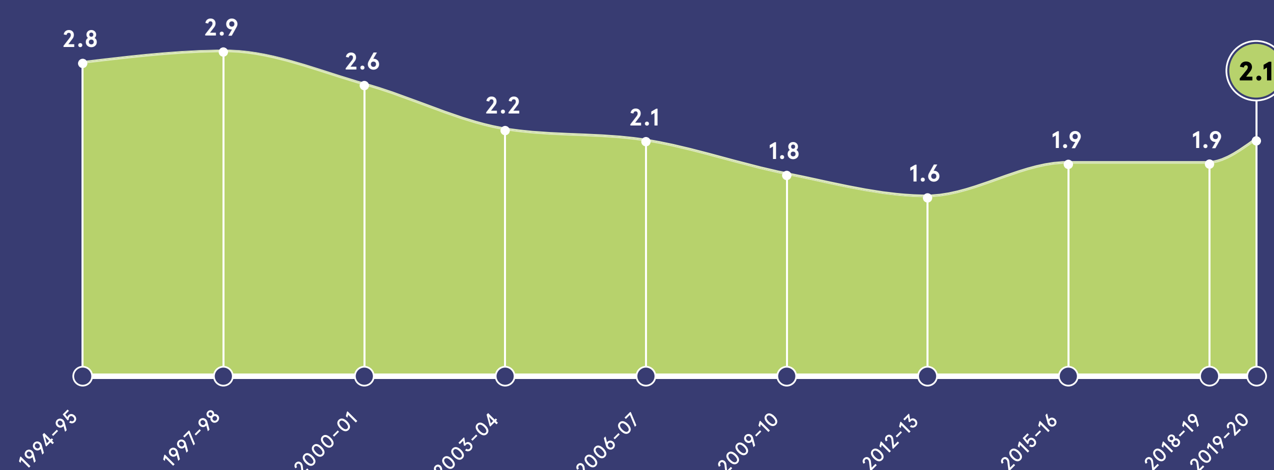
UNDERSTANDING THE UNDERPENSIONED

According to Age UK, 2.1 million pensioners in the UK are living in poverty. Ethnic minorities in particular are facing a retirement fraught with financial hardship: 33% of Asian or Asian British pensioners and 30% of Black or Black British pensioners are living in poverty, compared with only 16% of their white equivalents. Automatic enrolment is helping to narrow the gap for certain groups, but many more are still falling through the cracks

THE REALITIES OF RETIREMENT POVERTY

Age UK, 2021

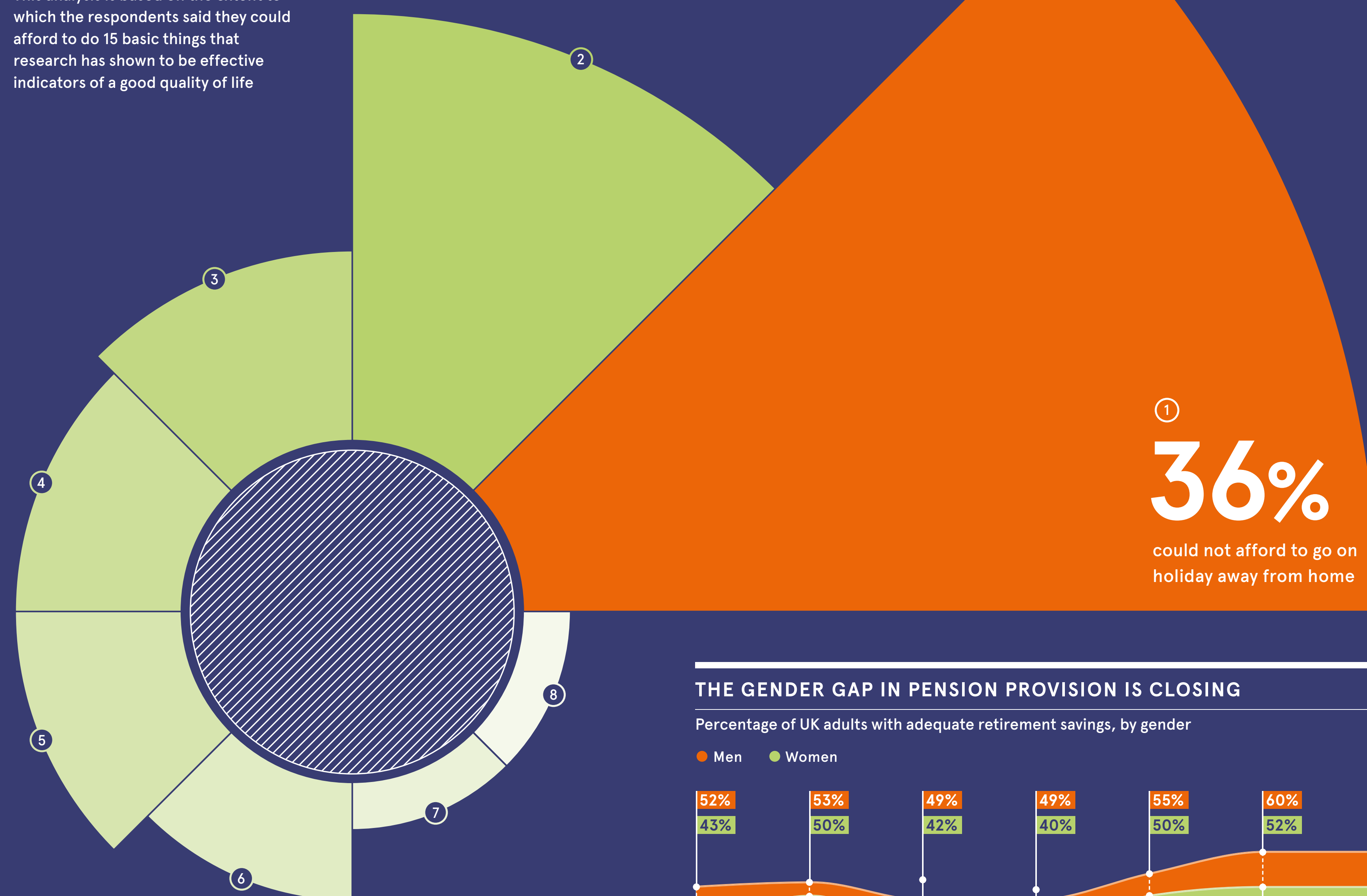
Number of UK pensioners living in poverty after housing costs (millions of people)



WHAT RETIREMENT POVERTY LOOKS LIKE

Age UK, 2021

Percentage of the UK population aged 65 or older suffering from some measure of material deprivation. This analysis is based on the extent to which the respondents said they could afford to do 15 basic things that research has shown to be effective indicators of a good quality of life



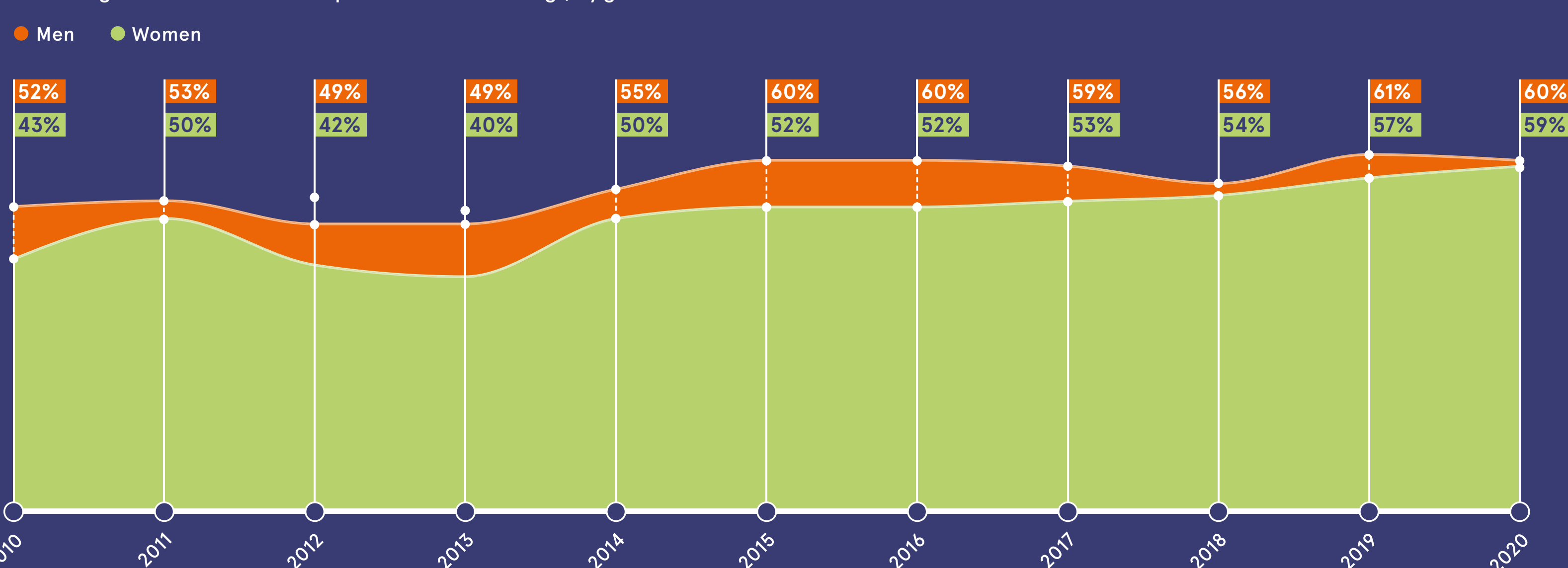
700,000 people aged 65 or over were living in "material deprivation" in 2019-20

- **18%** could not afford to go out socially at least once a month (2)
- **8%** would not have been able to meet an unexpected expense of £200 (3)
- **7%** did not have access to a car or taxi whenever they needed it (4)
- **7%** would not have been able to replace their cooker had it broken down (5)
- **5%** did not have a damp-free home (6)
- **2%** were unable to pay regular bills (7)
- **2%** could not keep their home warm enough at all times (8)

THE GENDER GAP IN PENSION PROVISION IS CLOSING

Scottish Widows, YouGov, 2020

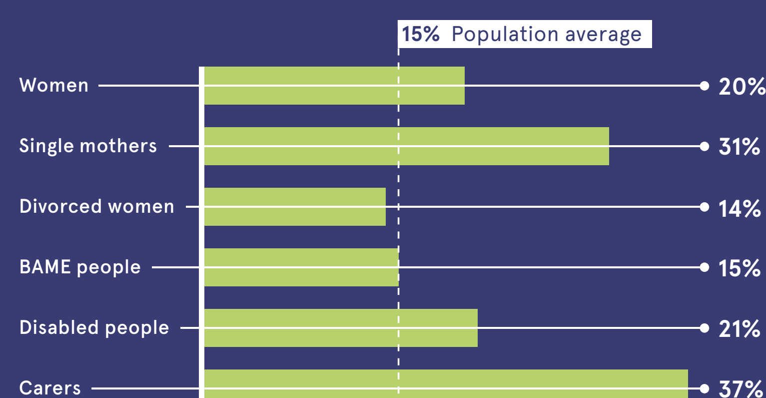
Percentage of UK adults with adequate retirement savings, by gender



THE GROUPS MOST AT RISK OF RETIREMENT POVERTY

Pensions Policy Institute, 2021

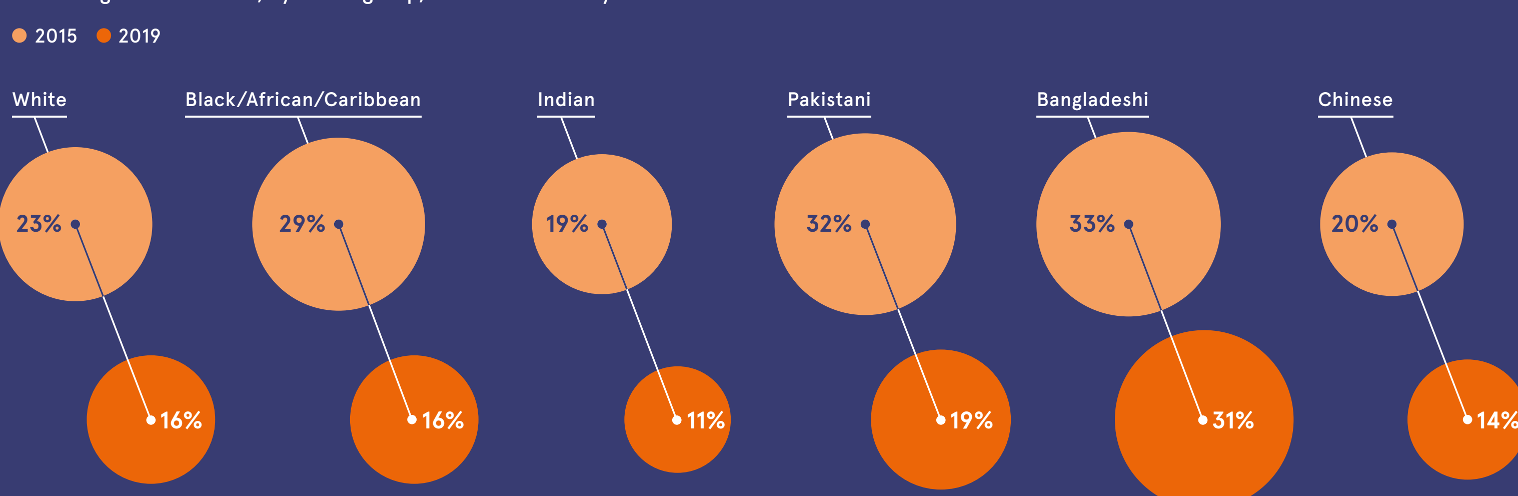
Proportion of Britons in employment who do not meet the automatic enrolment criteria



ELIGIBILITY FOR AUTO-ENROLMENT HAS BEEN INCREASING ACROSS THE BOARD

Pensions Policy Institute, 2021

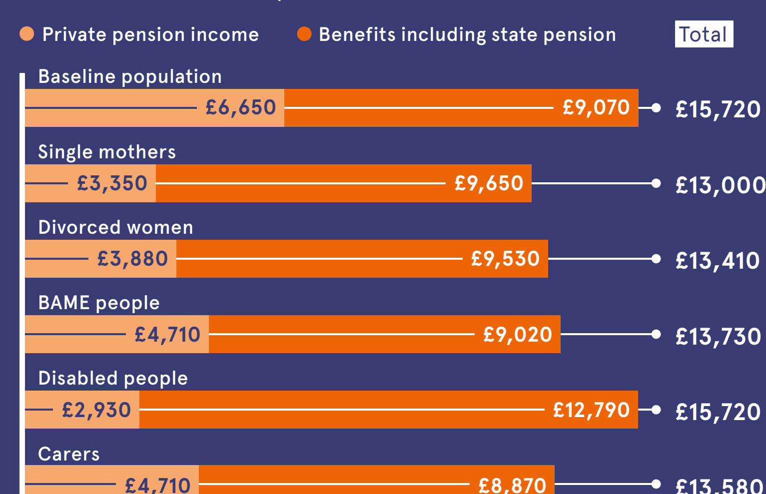
Percentage of UK citizens, by ethnic group, who did not satisfy the criteria for auto-enrolment in 2015 and 2019



THE INCOMES THAT UNDERPENSIONED GROUPS WILL HAVE TO LIVE ON

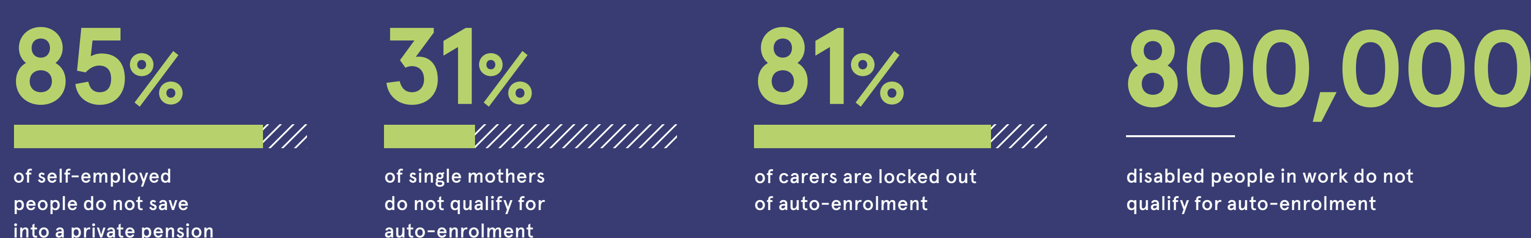
Now Pensions, 2021

Average annual retirement incomes of underpensioned groups, with and without the state pension



SEVERAL GROUPS ARE STILL FALLING THROUGH THE CRACKS

Now Pensions, 2021



LEGISLATION

A hard act to follow: testing times for trustees

The Pension Schemes Act 2021 imposes several stringent measures designed to safeguard funds. Chief among them is a new onus on trustee boards to play a stronger role in this effort

SOPA Images via Getty Images

Simon Brooke

The UK seems to legislate on pensions with metronomic regularity, with a new act arriving every three years on average since 1993. The latest of these, which came into force in February, promises to be more radical than most of its predecessors.

Along with imminent new regulations, the Pension Schemes Act 2021 is set to impose greater responsibilities on trustees, while other significant changes include a new funding regime for defined-benefit schemes; new criminal offences; and provisions designed to address climate change.

> Trustees are very much going to have these new provisions in their minds. There are many shades of grey, which will lead to a more cautious approach

The legislation also provides for the introduction of a new type of pension called a collective defined-contribution (CDC) scheme. This is a "mash-up of an occupational defined-benefit pension, which provides an employee with a set amount of money each year of their retirement, and a defined-contribution scheme, where a member retires with an investment portfolio that may or may not last them throughout their old age," says Annabelle Williams, personal finance specialist at Nutmeg.

It's hoped that CDC schemes, which are already common in the Netherlands and Canada, will draw on features of both pension types to form a hybrid with the potential to bridge the gap between the haves and the have-nots in retirement.

The act also introduces measures to combat scams. According to figures published in July by the Financial Conduct Authority, more than £2m had been lost to pension fraud in the preceding five months alone.

Most significantly, high-profile pension scandals in recent years, such as those affecting employees of BHS and Carillion, have fuelled demand for reforms to the trustee's role. In particular, the perceived lack of willingness or ability on the part of trustees to report concerns to the Pensions

The Pension Schemes Act 2021: an implementation timeline

- **February 2021** — The act receives Royal Assent
- **October 2021** — New measures to combat pensions scams; New criminal offences and regulatory powers; Managing and reporting on climate-related risks
- **Late 2022/ early 2023** — New funding requirements for DB schemes
- **2023** — Pension dashboards
- **TBC** — New notification requirements; Collective money-purchase schemes

2021 | 2022 | 2023 | 2024

Commercial feature

Visualising retirement: why pension decisions are about more than just pounds and pence

Increased pension complexity means individuals—and employers—need greater support for retirement planning

Pensions used to be a simple affair. You retired, you drew your pension and the hardest decision you had to make was how much tax-free cash to take. But since pension freedom rules came into effect six years ago and the world was turned on its head through Covid-19, people now have significantly more choice about what to do with their pension pots, but arguably tougher decisions to make about their true priorities. And more choice doesn't necessarily lead to better decisions, says Paul Chafer, chief commercial officer at Wren Sterling.

Some have revelled in the flexibility that working from home and a slower-paced lifestyle has given them and are looking at planning for retirement earlier and shifting to part-time work. For others, they now recognise that they are not saving enough to meet their retirement needs, says Chafer. For both of these groups, it is important for them to visualise their end game.

"That means thinking about what retirement looks like—what do you want to do, how long do you want to be doing it for and how much is it going to cost you," says Chafer. "Those are the conversations we have with clients to get them to view retirement in real-world terms rather than thinking about it just in pounds and pence."

While that may sound simple, it is often very difficult for clients to make that journey by themselves, usually for emotional reasons, says Chafer. Financial advice is as much about the psychology of making good decisions and putting people in a positive frame of mind to work towards clearly defined goals, as it is to do with squeezing investment performance, he adds.

"People want to maximise their income and their quality of life in retirement, but in a way that doesn't come back to haunt them—if they take on unnecessary risk, it could erode their pension pot and result in a retirement that does not match their wishes," Chafer says. "Working with an adviser gives them peace of mind that they're making the right long-term decisions, which can release a lot of stress."

Hidden value of advice

A common mistake people make is forgetting that their pension needs to provide them with an income for the remainder of their life.

"People receive a pension statement with a six or seven figure sum on it, forgetting that this is not a lottery win and it needs to last them for maybe 30 years, or more," says Chafer. "It's incumbent on an IFA to really understand the client and work with them to paint a picture of their retirement and how the plans we make with them are going to achieve those goals.

"We find those with a final salary pension scheme really benefit from the expertise of an adviser. We're often approached by people who think the best action for them to take is to transfer from their final salary scheme, however accessing pension benefits early is not suitable for everyone. Our role is to ascertain if that's in their best interests, as clients' retirement goals can often be achieved by drawing income from their final salary pension rather than transferring. Again, the benefit of an adviser is ensuring all options are considered with all of the client's investments, income and expenses being viewed in the round."

Parental corporates

It's not just individuals seeking this reassurance. Companies are increasingly adopting a more parental role by providing retirement planning advice on behalf of their employees, which Wren Sterling has done for over a decade.

"We support a number of FTSE 100 and FTSE 250 companies who understand that pensions are not always number one on their employees' priority list, but often, someone's pension pot is their largest asset and most difficult to deal with," says Chafer. "There is a move across all companies, not just large companies, to really concern themselves with financial wellness and understanding that when staff are concerned about their financial position, it detracts from their performance at work. Sorting out pensions and retirement can be a game-changer in many ways."

35% of UK adults admitted they had no idea how stock market falls can affect retirement savings, in a survey of 4000 Britons in 2021

LV=, 2021

Wren Sterling is a national firm of independent financial advisers who hold the Pension Transfer Gold Standard and are FSQS accredited. For more information or to book a free initial consultation, see wrensterling.com/understanding-pensions

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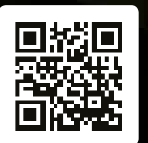

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Regulator (TPR) has drawn a lot of criticism. The criminal offences created by the act apply principally to employers, but they could also affect trustees, according to Anthea Whitton, pensions partner at law firm Eversheds Sutherland.

"The offences have become much broader in scope," she says. "For instance, the offence of wilful or reckless behaviour in relation to a pension scheme, as outlined in the government's white paper of March 2017, was said to be intended to tackle reckless bosses. Criminal liability would not be imposed on a person with a 'reasonable excuse', but the act provides no detail on what that means. The uncertainty is likely to cause concern for directors, trustees and third parties, given that the penalty is an unlimited fine or up to seven years' imprisonment. There's also the possibility of a civil sanction of up to £1m."

Nigel Down is search director at Trust Associates, a consultancy specialising in the recruitment of trustees and investment advisers for pension funds. He believes that it's "too early to tell what specific impact the act has made on the role of trustees, but it is clear that the overall intention is to make them more accountable for the decisions their schemes make and the effects these may have on their members. For example,

> It's too early to tell what specific impact the act has made on the role of trustees, but it is clear that the overall intention is to make them more accountable

the newly created offence of 'failure to act' shifts the burden of responsibility further on to trustees."

While the aim of the act is to encourage all those involved in managing pensions – especially defined-benefit schemes, given the recent scandals – to act more responsibly, many experts point out that it is broadly drawn. In light of the widely criticised handling of the BHS pension scheme as part of the company's sale in 2016, the legislation has been extended to cover a number of corporate transactions. However laudable the intentions of that move are, it means that the act is highly likely to create a period of uncertainty as trustees, advisers and shareholders wait to see how courts interpret the new provisions and what actions TPR takes.

Claire Carey a partner and pensions specialist at law firm Sackers, says: "There's always the risk that parties such as trustees and their advisers could get caught in the crossfire when having to consider any company proposals relating to defined-benefit schemes. Generally, trustees are very much going to have these new provisions in their minds. There are many shades of grey, which will lead to a more cautious approach."

The act also paves the way for new obligations relating to climate change (see the article on page 2). From 1 October, trustees of occupational pension schemes managing assets worth more than £5bn in total will be required to monitor and manage the impact of climate-related risks on their schemes.

Will the extra responsibilities and potential penalties deter people from becoming lay trustees?

"We anticipate that lay trustees may feel concerned about the risk of action against them, possibly to the point that it will be harder for some schemes to find member-nominated trustees," says Jo Myerson, a professional independent trustee and director at Ross Trustees. "For experienced professionals who are well advised and are asking the right questions, the risk is manageable. Indeed, we have long been accustomed to acting robustly. Our sense is that the most crucial piece of the jigsaw will be the audit trail to prove that any actions taken were reasonable."

It does seem likely that lay trustees will find themselves becoming more reliant on professional guidance from specialist providers. Three-quarters of those responding to a recent survey by the Pensions Management Institute said that they needed better access to information, for instance.

Ultimately, the goal of the government and the pensions industry alike is simply to ensure that trustees do all they can to safeguard pension pots, so that their contributors collect what they're due in retirement.

With this factor in mind, Gail Izat, workplace MD at Standard Life, says: "Given that this increased focus on governance encompasses the whole pensions landscape, it's likely that employers will be engaging earlier and more often with the trustees of the schemes they participate in." ●

'I feel a level of personal involvement as a trustee'

"One element of my new job that's surprised me somewhat is the level of responsibility I feel for the members of my schemes."

So says Tiziana Perrella, an actuary who joined Dalriada Trustees, an independent provider of trustee services, as a professional pension trustee at the end of last year.

Perrella believes that the Pension Schemes Act 2021 will increase the demand for greater professionalism on trustee boards, with more independent specialists being appointed alongside employer- and member-nominated trustees. She also foresees that a professional trustee company will be appointed as a scheme's sole corporate trustee in an increasing number of cases.

Given her actuarial background, Parrella is particularly interested in how the new legislation will affect pension governance. She envisages that it will have a beneficial effect in at least one respect

"A lack of clarity on endgame objectives leads to insufficient preparation, meaning that schemes miss out on market opportunities and the security of their members' benefits is not maximised as a result," she says. "I therefore believe that the requirement in the act for schemes to have a specific long-term strategy designed to deliver an agreed long-term objective is a positive development."

A compliance checklist for trustees

Pension trustees need to act now to comply with both the current regulations and those coming down the line.

1 Update your risk registers and review them regularly. TPR recommends the use of an agreed evaluation process to rate risk events based on the likelihood of their occurrence against their impact if they were to transpire.

2 Obtain professional advice on every aspect of your work and consider further training to improve your knowledge. The Pensions Management Institute offers an award in pension trusteeship based on TPR's indicative syllabus.

3 Check regularly whether any proposed action could, under the terms of the Pension Schemes Act 2021, be considered "conduct risking accrued scheme benefits" or "a notifiable event".

4 Ensure that you have a clear funding strategy for the long term, as well as a policy on climate-change reporting.

5 Keep your reporting structures under constant review. "Trustees will need to rethink internal processes to ensure that anything which needs to be reported under the act is captured – and that the sponsoring employer doesn't accidentally cause an offence," advises Anthea Whitton of Eversheds Sutherland. "In short, trustees have more reporting responsibilities under the new act and, if they fail to comply, more liabilities."

OPINION

'The success of 100 Black Interns has shown that, if we each do a little bit, we can create immense change at pace'

Over the past year I have witnessed something meaningful come to pass. Something that arrived so quietly, thoughtfully, and intentionally – vocabulary you perhaps wouldn't normally associate with the investment management industry. But countless individuals and companies have each invested a little bit of time and effort to join an initiative that aims to inspire a lasting change in society.

This change saw the investment management industry tackle the issue of race and underrepresentation head on. It did so by embracing a programme called 100 Black Interns. Now that the first stage is complete, the participants have not only proved it can work, but also reminded us that, if we each do a little bit, we can create immense change at pace.

The extent of the change we need to create is monumental. Just one relevant data point: there are only 14 Black portfolio managers in an industry that employs thousands of asset managers. But you shouldn't let huge challenges put you off.

In the space of only 12 months, the project went from a discussion between four committed founders to delivering more than 500 internships this summer. I, along with others, heard what they were doing and wanted to see how I could help.

The programme meant that the companies involved changed their recruitment practices, updated the fundamental structure of their graduate programmes and hired interns into full-time roles. This is a snapshot of success in one industry, but there is so much more work to be done. So, in 2022, we will run the expanded programme – 10,000 Black Interns – in 24 sectors across the UK economy.

In business and beyond, tonnes of amazing ideas are generated every day. It seems obvious, but a lot of them don't come to fruition because they aren't broken down into manageable steps. Execution is essential – and it is equally important to continually refine your process. Research shows that the average C-suite executive gets about 70% of their initial decisions wrong. Success follows those who take on new information and iterate execution and strategy at every point.

To get others on board, you have to eliminate friction from the system, not accepting the excuses that say 'no', 'that's too hard' or 'I'll do that tomorrow'. Make it so easy that they can do it today. And show them how. This is how a movement starts.

Which brings me to my central point about the power of continuous and incremental improvements. An overnight success is rarely that. It is simply countless hours of following a playbook one step at a time. Imagine if we all borrowed this idea. Imagine how much change and innovation we could bring to our industry. All of the problems that appeared insurmountable suddenly become achievable.

My industry, the pensions industry, has all sorts of problems that are filed under the 'that can't happen' category or are simply considered 'difficult'. One persistent challenge is getting people to save money for their retirement. Those that have been successful have used language that is crystal clear and made a compelling argument that can be boiled down into a single sentence. It's something that's really difficult to do – I know, because I try every day. All I can do is follow the playbook and try again.

So, when it comes to 10,000 Black Interns, we have kept things simple – for example, by offering defaults: register to take an intern or tell someone who you think could benefit. Make it as easy as copying one hyperlink and pasting it into a WhatsApp message saying 'we need to do this' or 'you should apply'. What's your knotty problem? Don't be afraid of the scale of the challenge. Just get started and see where you're able to go. ●

Stuart Breyer
Chief executive, mallowstreet

Commercial feature

Q&A
How pension schemes are turning pro

The pace of regulatory change in the pensions industry is making it harder for pension scheme trustees to keep up, prompting more and more trustee boards to seek professional support

Pension scheme trustees have never had it tougher. As the regulatory environment intensifies, the volume and complexity of work that trustees are expected to handle is becoming increasingly challenging. From rules around environmental, social and governance reporting to issues stemming from underfunded defined benefit pension schemes, the skills needed are broader than trustees have required in the past. At the same time, heightened scrutiny on trustee board decisions is placing even more burden on lay trustees that might not have the necessary technical knowledge or expertise.

Against that backdrop, trustees have an increasing number of options to achieve greater professionalism on their boards. One is to hire professional trustees – seasoned industry professionals who usually have a specialist area of expertise. Similarly, more schemes are adopting fiduciary management, which involves working with investment specialists to support trustees in achieving their objectives. Cardano's Helen Prior (above left) and Magda Kennedy (above right) explain why it is essential for trustee boards to adopt a professional approach to their fiduciary duties and how it is leading to increasing appointments of professional trustees and fiduciary managers.

> Trustees have an increasing number of options to achieve greater professionalism on their boards

Q What are the potential risks for trustee boards that don't embrace greater professionalism?

HP The first issue is a failure to comply with the rules – legal compliance isn't the gold standard, it is a basic threshold. There's no doubt if you aren't embracing greater professionalism, it's harder and harder to be confident that you are demonstrating legal compliance. Another potential risk is missing something that could have safeguarded or improved your scheme's ability to pay pensions as they fall due. It could be related to the sponsor's health, it could be an investment opportunity or risk, but often those things occur together, so it's very difficult if you're not embracing greater professionalism to be confident that you are future proofing your scheme.

MK As the majority of defined benefit schemes are now closed to accrual and many members are no longer associated with the sponsor due to acquisitions or disposals, it's much more difficult to find suitable and willing talent to fulfil the role of trustees, and so trustee boards are becoming smaller and less diverse. Although lay trustees provide a very important role, there are fewer and fewer of them, and as the pool of willing participants shrinks, it's harder to have a diverse and well-functioning board.

Q Why should schemes consider using fiduciary managers or professional trustees, and what are the main benefits of doing so?

MK For starters, it can help with the time burden. Managing increased complexity, preparing for new regulatory requirements and keeping up with the latest guidance related to defined benefit pension schemes is time consuming. Also, fiduciary managers and professional trustees are likely to have access to a wider range of expertise beyond your own capacity, which can help provide more rounded advice and support to trustee boards.

HP One of the benefits that external professionals can bring is the ability to manage some often quite difficult conflicts of interest. For example, if you're a trustee in a heated funding negotiation with the sponsor but you are also employed by the sponsor, that can put you in a very difficult position. An independent perspective can be a really helpful way for a trustee board to be confident they've got the balance right because they've got somebody with a slightly different perspective to help manage those types of discussions.

Q How else can schemes address these challenges?

HP It isn't a one-size-fits-all approach. In our experience, professional trustees have been a great asset to the schemes they support, and this sector is growing rapidly. To complement this trend, the past decade has also seen the rise of fiduciary management as a way to help trustees get up the professionalism curve. Using a fiduciary manager – in other words, delegating some of the day-to-day investment decisions to a specialist investment manager – means trustees can spend more time on the big picture issues.

You can draw a parallel here to the way companies are governed where you have a non-executive board that gives independent oversight and then you have a separate executive that focuses on actually running the business day-to-day. Having one group doing both things, which is the traditional trustee model, can be challenging, so engaging a fiduciary management provider is another way of helping trustees demonstrate professionalism.

Q To what extent are schemes looking to adopt a sole trustee model?

HP We are starting to see more use of sole trustees. Previously, it was more common when a scheme was perhaps already winding up and the strategic decisions had been made, but there was a lot of administration that needed to happen and so a professional sole trustee was a useful governance model for that. However, more recently we've seen a lot of schemes struggle to get new trustees, particularly if they have been closed to new entrants for a long time, and so a sole trustee model is one way to solve that problem.

> Using a fiduciary manager means trustees can spend more time on the big picture issues

Q What impact has the growth of professional corporate trustee firms and fiduciary managers had on the pensions industry?

MK Professional trustees and fiduciary managers can provide guidance and a stronger voice – and they are also better equipped to challenge existing processes. Trustees don't know what they don't know, so helping trustee boards articulate questions and concerns, and having that experience of the broader pensions industry is very helpful.

The potential implications for pension schemes are clear, with increased regulatory scrutiny comes greater legal burden. Appointing professional trustees and partnering with a fiduciary manager are some of the ways schemes can demonstrate to regulators that the decisions they have taken are fair and reasonable. And with the regulatory burden unlikely to ease, this trend is going to continue.

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DEFINED CONTRIBUTION

Bigger should mean better for DC pensions

As occupational pensions increasingly move from defined-benefit to defined-contribution plans, their members need to know that they can trust their scheme

Pádraig Floyd

Workplace pensions is a market in flux. For more than two decades, employers have been replacing defined-benefit (DB) pension schemes with defined-contribution (DC) arrangements. The reason for this is simple: they are no longer prepared to shoulder the risk of DB scheme liabilities and have passed the investment risk on to their (often unsuspecting) employees.

In 2012, the government started the auto-enrolment (AE) project in order to increase the number of employees saving for their retirement and to reduce pensioner poverty and the burden this might place on the state. On the face of it, AE has been a resounding success. Since October 2012, more than 10.5 million people have been automatically enrolled in occupational pensions who were previously ineligible or had simply opted out. But the sums that have been saved into these workplace pensions are small – and have been falling over time, according to research by the Pensions Regulator (TPR).

> A number of master trusts are looking to grow or leave the market because they're not cost-effective at their current size

So, after almost a decade, the government is increasing the pressure on employers to not only offer pensions to employees but also improve those offerings. New requirements in the Pension Schemes Act 2021 for DC schemes include beefing up enforcement; increasing reporting requirements; and directing schemes to prepare for the so-called dashboard project, which is in progress but has encountered a number of delays.

Helen Ball, a partner at specialist pensions law firm Sackers, believes that AE was the catalyst for improving the protections applying to the average DC scheme member. Previously, there was little legislation specifically governing this area. Once AE was implemented, a code of practice was published, followed by regulations.

"This definitely has improved and tightened up decision-making in DC schemes," she says. "A simple example is that many such schemes would not have reviewed their investment strategy often, or even at all, before. There is now a legal requirement on them to review the default investment strategy every three years."

TPR's insistence on greater board diversity for DC trustee boards and the lengths it went to authorise master trusts in 2017 have also improved standards, Ball adds. But she questions whether such measures have truly targeted the schemes of most concern to the regulator: non-compliant ones that are often smaller in size. TPR has also acknowledged that small schemes are not necessarily bad schemes.

While the average DC scheme member is now better protected, that doesn't improve their understanding of the quality of their scheme. It also doesn't prepare them for the retirement they might expect.

According to Aon's *DC Pension and Financial Wellbeing Employee Research 2021*, employees are generally concerned about saving for the future. A quarter of the respondents believe that they will never be able to retire and at least half think they will have to work past the age of 68. Almost nine in every 10 (87%) are expecting a shortfall in their retirement income.

Some say they're prepared to save more in the future or economise in retirement, although 11% accept that they don't yet know how they will address this.

Almost three-quarters (71%) of respondents have no idea how much they need to

IT'S TIME TO START PLANNING FOR RETIREMENT

Aon, 2021

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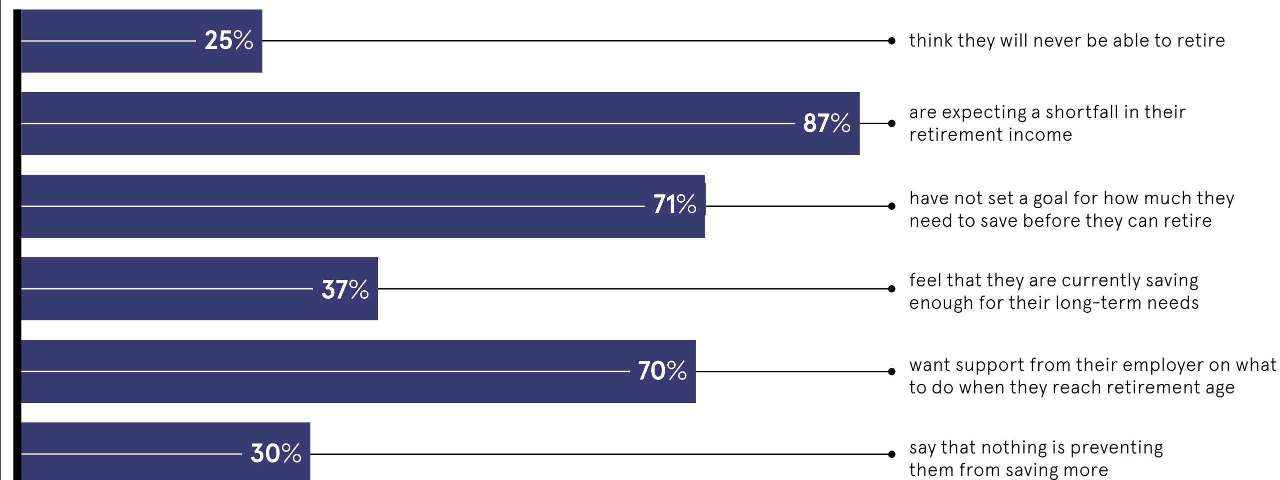

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'Flexi' retirement? Here's what you need to know

Some people may wish to carry on working after pension savings have been accessed, but knowing how to plan for this is crucial

The past 18 months have been like no other. The scale and pace of change that we have all had to deal with has prompted many to reconsider their professional and personal priorities. For some, this will have sparked thoughts about retirement.

Stepping back from the workplace can feel daunting, especially when it's the culmination of a life's work. For others, giving up work entirely simply isn't financially practical. That's why flexi-retirement is becoming the go-to choice for many.

This usually means continuing to work after pension savings have been accessed, whether in the same job, a new role or on reduced hours.

But making any change to your retirement plans will have financial implications – so proper planning is key. In particular, there are two steps you should take before making any firm decisions.

The first is to decide what you want to achieve with a flexi-retirement, be it more free time to travel, a new home or to pay for a child's education or house deposit.

Once a goal is in place, reviewing financial incomings and outgoings – what money is spent on now, what it might be spent on in the future and overall living costs – will help you set the framework to decide what is needed financially to make that goal possible.

Both establishing goals and reviewing outgoings is something that a professional financial adviser can help with. Some will use specialist cashflow modelling tools that look at current and future data on income, expenditure and lifestyle to show how cash requirements might rise or fall over time, helping provide a clear overview of what money is needed.

The next step is to unlock the right amount of pension savings. Some will want to take a tax-free lump sum from their retirement

pot to fund their retirement, which could be as much as 25% of your savings. The earliest this can be accessed is usually at the age of 55 but this will depend on the rules of the pension scheme you are in. While accessing your pension before taking full retirement may be beneficial now, it will also affect the amount of income available in the remaining period of the plan.

Many people have alternative pension pots and savings available to them. Having a wider choice of options does mean that tax charges, such as the annual allowance, can come into play. The annual allowance means there is no tax relief on any pension saving over £40,000 in a year.

Savers should be mindful of the Money Purchase Annual Allowance (MPAA) too, which can reduce annual allowance. Those affected by the MPAA can be modest earners with salaries of £30,000 a year, for example if their pension contribution rate is more than 13.4% it could breach the limit, once their employer contributions and qualified pension growth is included.

Being mindful of these limits can help avoid tax issues – particularly for those wanting to continue to work.

Only once you have established a clear goal, and made sure you can afford to access the funds required without triggering tax charges or compromising your plans for later in life, should you commit to any decisions.

These can be complex issues with a multitude of aspects to consider. However, your retirement is important so getting the right advice is essential. Having a sound strategy will support the best outcome.

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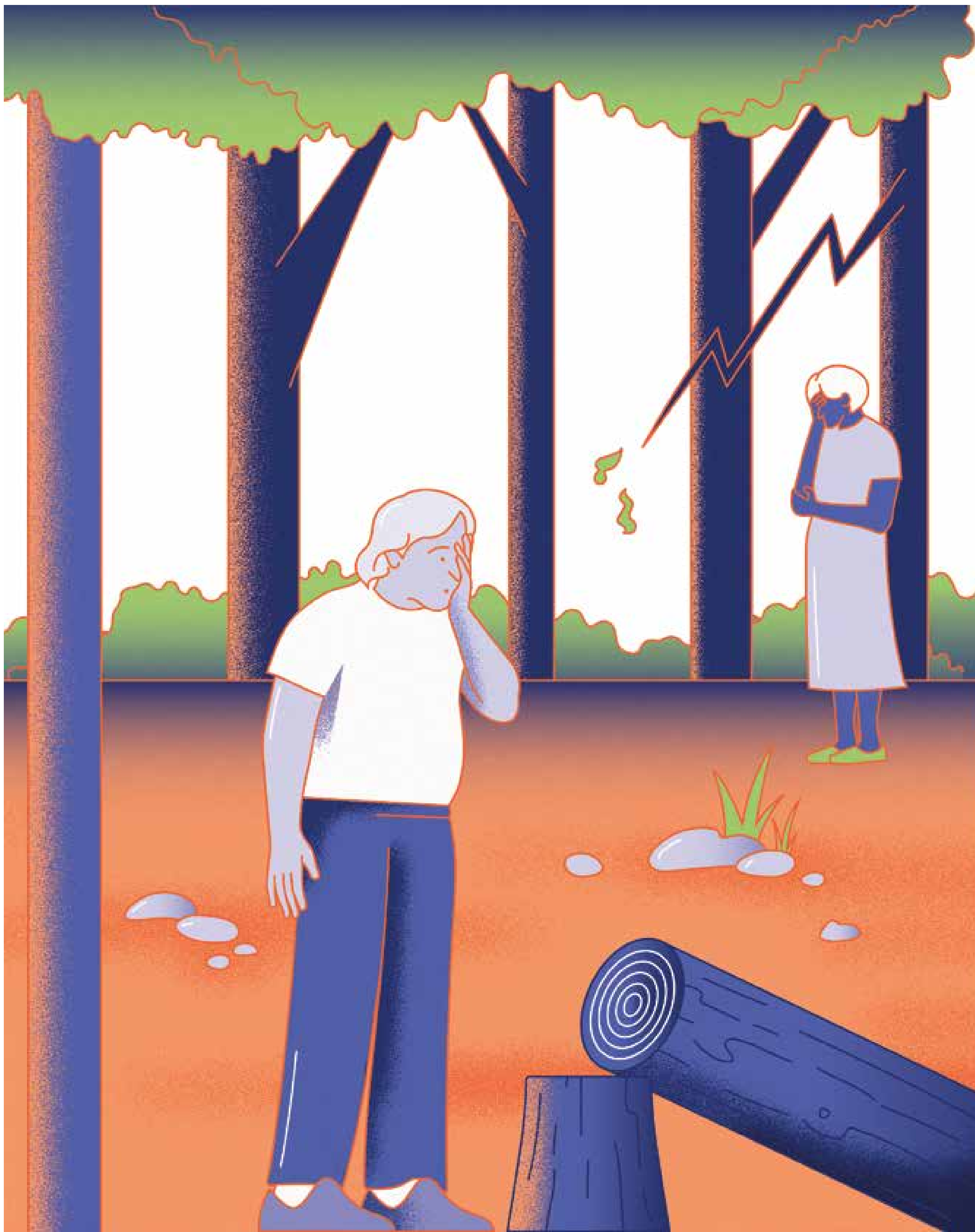


save before they can retire. This figure is significantly higher among women (76%).

Perhaps of greatest concern should be that 63% of those with the least time to save – respondents above the age of 55 – have not set a financial goal for retirement. Almost two-thirds of employees (63%) feel that they aren't saving enough to meet their long-term needs, while a third say they can probably afford to save more for the future. Fewer than a third say they can't afford to save more and a quarter say that other financial goals are more important to them. But more than a third (34%) say that there's nothing stopping them from saving more now.

"People haven't got the tools to understand that, because they haven't had any financial education," Ball says. "That is really why schemes are being compelled to demonstrate value for members."

The Aon study shows that one in every seven employers are looking to save money in the way they run their DC plans. There has certainly been a move away from running small schemes. TPR data shows that, while the vast majority of schemes have fewer than 12 members, the number of small ones has been falling year on year.

There may have been good reasons for running a standalone DC plan in the past, but the need to prove value for money to members is forcing some schemes to seek alternatives. Even some with more than £1bn in assets have realised that someone else may be able to do a better job of managing the pension than they will.

The regulator is keen to have a simpler market to oversee with fewer moving parts, although this does not mandate consolidation with a third-party specialist such as an insurer or master trust.

> **The value an individual has in their current pension arrangement can be judged only by that person themselves**

Employers that choose consolidation have a responsibility to consider the best value, stresses Alistair McQueen, head of retirement and saving at Aviva. "We must always remember that when we – employers, trustees or regulators – talk of consolidation, we are in fact talking about other people's money," he says. "The value an individual has in their current pension arrangement can be judged only by that person themselves."

The Aon research shows that few people have an informed opinion about their scheme, but McQueen is confident that most employers are conscious of their duty of care. "Any good employer will act in the best interests of its employees," he says. "The fastest-growing section of this market is the master trust, but the employer and trustees must decide whether that is the right option in each case."

For employers selecting a business to run their workplace scheme, it's vital to consider whether the chosen company is committed to the long term.

"There will be further consolidation in the master trust market," predicts Andrew Cheseldine, a professional trustee and chair of the trustee board at master trust Smart Pension. "A number of master trusts are looking to grow or leave the market because they're not cost-effective at their current size."

Since their authorisation, master trusts are financially stronger. Like insurance companies – which have their own master trusts – they are required to keep reserves.

"While there may be some disadvantages to members, such as not having the same tailored service when moving to a master trust, they will generally be in a stronger scheme. They may also gain some comfort from having a brand that they're familiar with," says Robin Dargie, senior consultant at Quantum Advisory.

Cheseldine stresses that this doesn't necessarily mean that schemes will become any cheaper to run. Although there is a charge cap set at 75 basis points (0.75%), the average master trust will already be offering 50 basis points (0.5%). But it may drive down fees for standalone DC schemes.

"Employers will see a benefit, because quite often they're subsidising DC," he says. "Members will see an improvement in security, because they'll be part of a much bigger, better-regulated scheme."

AE has caused another problem that won't be resolved by the consolidation of smaller DC schemes. Many individuals have small pots from being enrolled while working in short-term jobs. These are often unclaimed by their owners, because they have lost track of them or are even unaware that they ever existed. Their value is undermined by ongoing charges, so consumers would be better off if these were put to work in a single pension vehicle.

There are 9 million small pots that are each worth less than £2,000, according to Cheseldine, who is on a working party seeking a way to consolidate them.

"At this rate, there will be 20 million small pots by 2025," he says. "While this is a separate issue from driving up standards through consolidation, it doesn't mean that we shouldn't think about it, as both matters could have a considerable impact on people's retirement incomes." ●

katleho Seisa via Getty Images

A brave new DC world

The pension business isn't known as a hotbed of innovation. Revolution, when it comes, tends to happen at a glacial pace. The arrival of the collective defined contribution (CDC) scheme is no exception to this.

The Pension Schemes Act 2021 finally provides legislation to allow the formation of CDC schemes. As with DB schemes, employers pay a fixed rate of contributions into the scheme and members are paid pensions. But the difference is that increases on those pensions will vary according to affordability. This way, an employer can share the risk of providing such a benefit with the members.

The attraction for employers is that the costs are fixed, so their pension budgets won't need to vary.

Members may expect a pension payment 70% higher on average than they might achieve from buying an annuity with a DC pot, and 40% higher than that provided under a typical DB scheme, according to research by consultancy Willis Towers Watson.

Volatility – the curse of DC investments, particularly for members who are close to retirement – is smoothed out so that pension levels are relatively stable. CDC may also mean there's less chance of members outliving their assets, as is the risk with an income drawdown solution.

Trade unions are rather more positive about the potential for CDC than traditional DC. In fact, Royal Mail and the Communications Workers Union have been lobbying hard for a change in legislation so a CDC scheme for up to 140,000 members might be created.

McQueen can see why Royal Mail finds CDC an interesting alternative. As a large employer, it has a highly unionised workforce, while it currently has a DB pension arrangement. Such factors make CDCs attractive to it.

"We will watch with interest to see how Royal Mail takes advantage of this," he says.

CDC also has its critics. Baroness Altmann, who was minister of state for pensions in 2015-16, is "very nervous" about the arrival of such schemes. One of her concerns is the potential impact of members' ability to transfer out of the scheme on the scheme itself.

"There's no provision for risk margin," she says. "If you transfer out, the expectation seems to be that you get the full current value. While you're perfectly entitled under the current system to do this, I think there should be a haircut to the transfer value."

Altmann sees a potential unfairness, which could lead different generations to select against each other and maximising their cut. This could undermine the point of a collective vehicle. "The risk to the individuals in the CDC scheme could be that it delivers no pension at all," she adds.

Cheseldine also struggles with balancing fairness for all members with the ability to transfer out of the scheme. But, despite his reservations, he thinks CDC could prove to be a useful tool in post-retirement benefits.

"It's a good start and Royal Mail will help to test the model, because it is such a big organisation," he says. "But the problem will come when people start trying to sell it to much smaller organisations with less stable workforces."

Commercial feature

Q&A

Can pensions aid employers in the war for talent?

As the war for talent intensifies globally, **Stuart Heatley**, managing director at Capita Pension Solutions, says pensions have a key role to play in both recruitment and retention

Q How has the jobs market evolved over the past couple of years?

A There is a shortage of skills across many industries and the 'war for talent' that analysts have spoken about in recent years is really coming to the fore. Some economists are referring to the current time as the 'Great Resignation', as the number of people looking to change jobs is higher than ever.

A global survey by Microsoft discovered that 41% of workers are considering quitting their job, rising to more than half of those aged 18 to 25, while a UK study by Persenio found 38% of workers plan to quit within the next year. A lot of this is pent up demand after people took a wait-and-see approach during the Covid crisis, but the pandemic has also changed what people expect from their employer.

Q How is this affecting companies' employee value proposition?

A The employee value proposition is changing considerably, as employers look to adapt to a changing mindset among workers. The pandemic has shown that employees can work productively remotely and this has opened people's eyes to the big wide world. I was recently asked by an employee if they could move to Crete and work from there. My daughter works for a business in Kent but lives in Glasgow.

The flexibility of remote working was previously seen as a perk, but for many this is now offered as standard. This means employers need to be able to differentiate in alternative ways. Work-life balance is now more important than salary for two-thirds of UK workers, a recent Randstad study found. Salaries are almost becoming neutralised, with staff increasingly asking, 'What else am I getting?' Beyond salary and bonus, pensions are the most valuable benefit you can get from an employer.

Q Do pensions really matter to younger workers when they are choosing a job?

A They do to an extent, but if we switch 'do' with 'should' in that question, then the answer is 'yes, they absolutely should'. The challenge is that a lot of people don't really understand pensions, despite millions of new savers joining pension schemes since the introduction of automatic enrolment. There is still a big education gap that we as an industry, and employers, need to fix.

When I started working 30 years ago, pensions were based on a different system. Nobody really paid attention to them, because you just got a proportion of your salary when you retired. It's now a very different, savings-based system that requires more engagement at a younger age to get a better return. Unfortunately, the pensions inertia from prior generations has lived on. We need to find ways to change that because pensions can be a fantastic tool to attract and retain talent. They are a key part of the employee value proposition because it's not just about rewarding people today but also looking after them further on in their life.

> **Pensions inertia from prior generations has lived on. We need to find ways to change that because pensions can be a fantastic tool to attract and retain talent**

Q What is it going to take to get people more engaged in their pensions?

A We need a time machine transporting younger workers forward to their 50s and beyond, so they can understand what kind of life they will want to live then and, more importantly, how they will be able to afford it.

Many of our desires remain very similar, such as travel, wanting a nice place to live and a nice car, but there are different priorities too. You might be putting your kids through university or trying to pay your mortgage off. What income will you require to do all of that and live a comfortable life, and are you saving enough into your pension now to enable that? The answer, in most cases, is no.

A time machine would help young workers understand that. And while it might sound like science fiction, there are technology tools we are developing now to provide that kind of experience. We need to virtually take people to different points in their life and show them how it feels.

Q How is Capita supporting trustees and companies in this area?

A As well as developing online functionality, which will help to create the time machine concept to support better retirement planning and decision making, we also support employers by managing their auto-enrolments and through communication. We work with trustees and employers to put together communication plans to educate and raise awareness.

> **We need to virtually take people to different points in their life and show them how it feels**

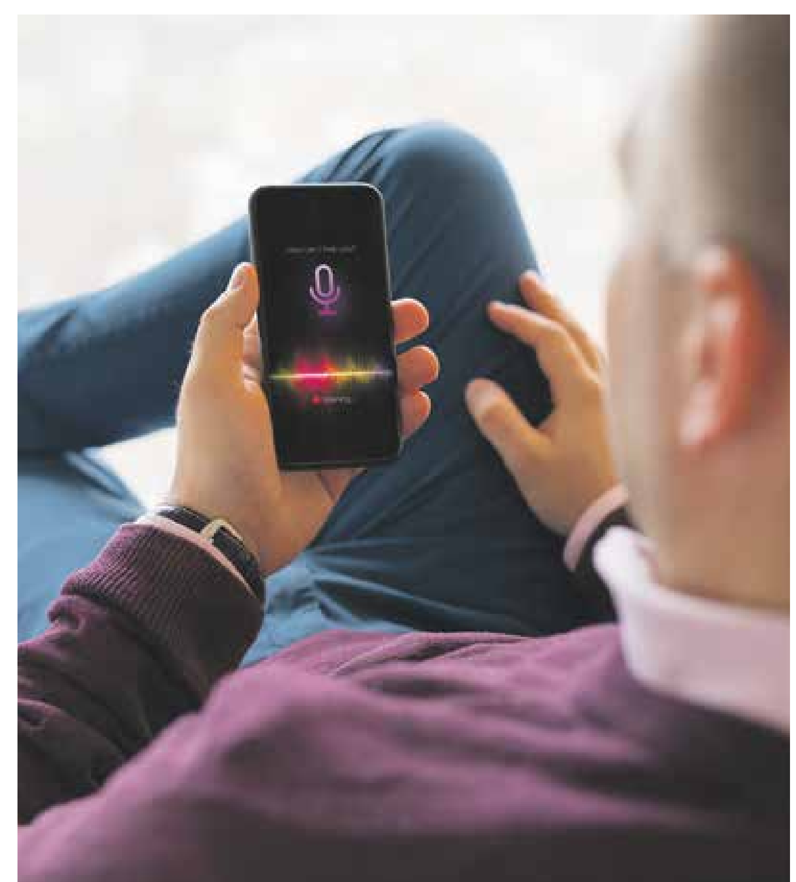
We also have a data remediation business, which is key. As pensions are a long-term savings pot, it's a challenge to keep pensions data fully accurate over an individual's working life. This is unlike banking data, for example, because people realise very quickly if something in their bank account isn't right. We work with employers and pension trustees to show them what good data looks like, the quality of the data that they have got and what action they need to take to get it to the right place.

Q How do you see the pensions landscape evolving in the coming years, particularly as it collides with the war for talent?

A A pensions dashboard will launch from 2023 providing individuals with much more information about what they have. If you've had lots of different jobs, which is increasingly likely in the gig economy, you will finally be able to see everything in one place. The key will be helping people to make decisions based on that aggregated information.

A big question we will need to answer as an industry is whether pension pots will start to follow individuals rather than being driven by employers, as is being introduced in Australia. This ownership will see pensions become an even bigger part of employment conversation. Your question to your new employer becomes, 'How much are you going to pay into my pension pot?'.

Alongside the education time machine, people will know what they need to put into the pension pot to get to where they want to be when they are 50, 60, 70 years old and beyond. The working world is very different now and we must all evolve to embrace not only technology but a more flexible pension system.



For more information, visit content.capita.com/pensions

Capita

TAXATION

Coming to grips with the lifetime allowance

If your pension pot breaches the £1m mark, you could face a punitive tax bill when you retire. So how can you protect your funds?

Marianne Curphey

With a significant proportion of the UK population facing a shortfall in retirement income, the government has used tax breaks to encourage long-term pension saving. But those who save too much could face a potential tax charge of up to 55% if the value of their fund exceeds an upper limit known as the lifetime allowance (LTA).

Under the current rules, a pension saver is allowed to make an annual contribution of 100% of their income, capped at £40,000. Those who have regularly made large contributions to their pensions over the years could fall foul of the LTA should they have accumulated more than £1m in their pension pot. Any funds above the threshold would be subject to 55% tax if withdrawn as a lump sum, or 25% if taken as income

The LTA was introduced in 2006, when it was set at £1.5m. It peaked at £1.8m in 2010, but thereafter it was either frozen or reduced until 2017, after which it started rising again, in line with inflation. In this year's spring budget, the government said that the current cap (£1,073,100) would be frozen for five years. But there have been discussions about reducing it again. One leaked proposal is to slash it to about £800,000. This would draw many more pension savers into the LTA net.

Broadly, there are two types of pension scheme. A final-salary or defined-benefit (DB) pension – common in the public sector – pays you a proportion of your former salary when you retire. A money-purchase or defined-contribution (DC) pension is found more often in the private sector. In this case, contributions from you and your employer are invested on your behalf. The value of those investments is the pot of money that you can then use to generate an income through retirement.

A pension fund of £1m may sound like a lot, but, if you have a private pension, that will buy you an annual income of only just over the annual average salary in the UK, notes Romi Savova, CEO of PensionBee.

> A £1m pension pot would generate an income of roughly £35,000 a year, which is not an excessive amount for many retirees

"Using certain estimates, a £1m pension pot would generate an income of roughly £35,000 a year, which is not an excessive amount for many retirees who find themselves free from work and looking forward to enjoying their retirement," she says.

One of the anomalies in the LTA rules is that the cap hits people who have a private-sector pension or personal pension harder than those who have a public-sector pension. Nevertheless, the LTA has been blamed for the decision of some senior doctors – members of the NHS pension scheme – to retire early.

Take the amount of pension income that you would expect from a DB scheme and multiply that by 20 to give you a notional pot value, according to Pete Glancy, head of policy, pensions and investments at Lloyds Banking Group. It's a lot simpler for DC schemes, he says, where you simply look at the actual value of the pot.

"Of course, many people will have worked in both the private sector and the public sector during their working lives," Glancy notes, adding that it's actually very difficult for people to determine whether they'll have to deal with the LTA.

"You would need to contact the administrator of each pension scheme for each employer with which you worked in the past, ask them to provide an illustrated value of the benefits and then apply some complex maths," Glancy says. "This will include assumptions about investment growth and inflation."

It's best to work with a professional financial adviser who can do all of this for you. Financial advice comes at a cost, of course, but you could potentially avoid tax penalties running to tens or even hundreds of thousands of pounds.

The LTA applies to the value of all your pensions, except for the state pension. Only the funds that exceed the LTA are subject to the charge, not the whole fund.

The LTA charge is applicable when certain conditions are met. First, if you die before the age of 75 and your funds have not been accessed at all. Second, if you reach 75 and you haven't accessed your funds or they're in pension drawdown. Third, if you decide to take pension benefits, either in the form of a tax-free lump sum, a regular sum, or pensions drawdown. Or lastly, if you transfer your pension funds overseas.

According to HMRC statistics obtained by pensions consultancy LCP, more than 325,000 people have registered for protection against the LTA since 2006 (see "How can I protect myself?", opposite page). But only about 4,000 have done so this year. As a result, some who can benefit could face unnecessary tax bills, LCP warns.

Matthew Arends, head of UK retirement policy at Aon, says that reducing the LTA would potentially make a new swathe of pension savers liable to a tax charge. This is particularly the case for private-sector employees saving into DC pensions.

"As the assessment of the LTA is more generous to DB pensions than it is to DC pensions, this creates a disparity between the public and private sectors," Arends says. "The most likely mitigation action for those with DB pensions would be to consider retiring early, if a reduction would be applied to the pension to reflect the early payment. There are no mitigation actions for DC pensions."

Again, this is a complex area in which you should seek financial advice.

"Mitigating the size of the tax penalty could involve changes in the amount you save into a pension versus other savings products, such as ISAs," Glancy observes.

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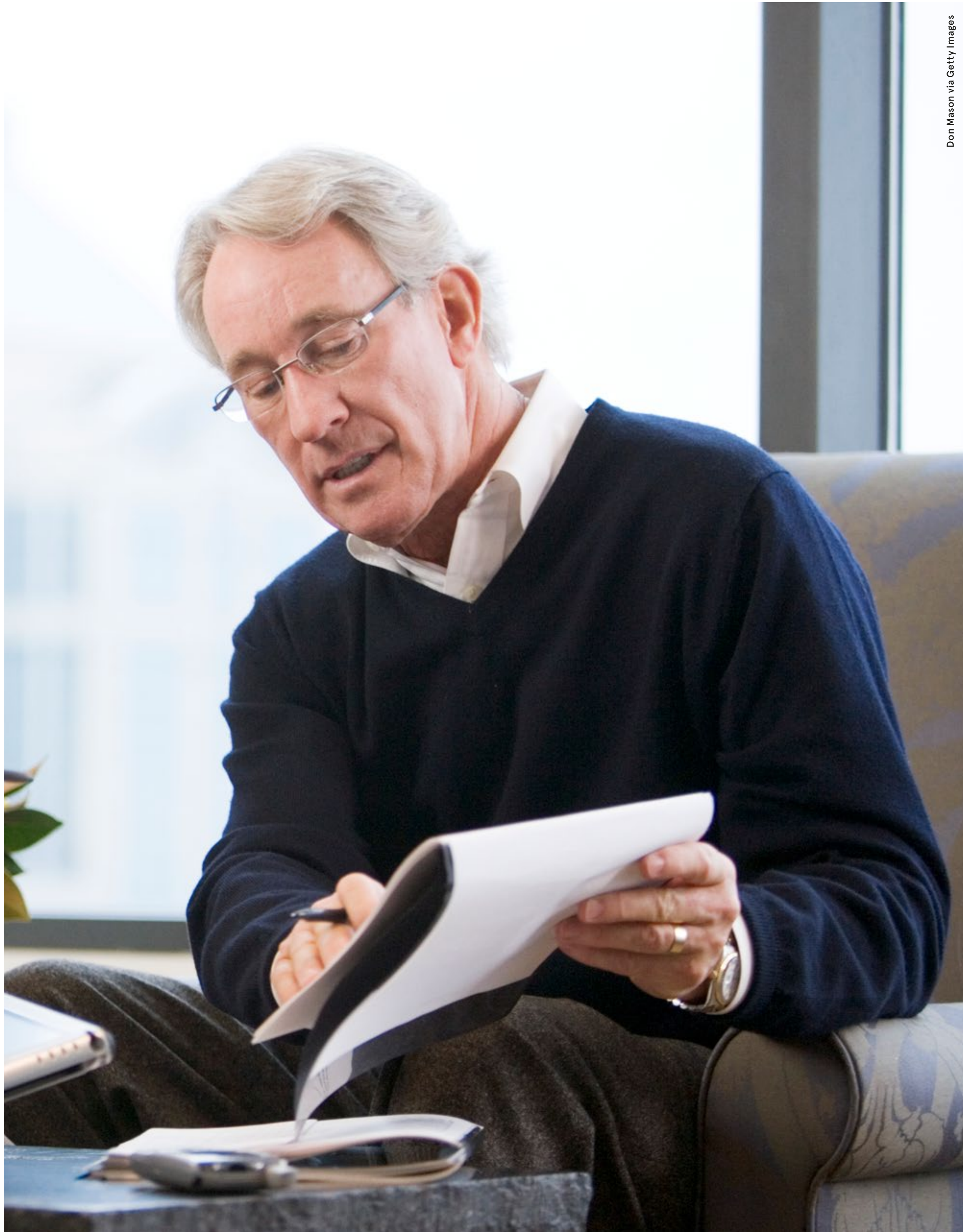


"Alternatively, it could involve changes to the way in which your money is invested. Or it could involve changes to the timing and phasing of your retirement. These are complex considerations and unique to each individual's circumstances."

Savova says: "People who find themselves on or near the threshold should consider whether it makes sense to divert some of their savings to another tax-effective vehicle, such as an ISA, to avoid penalties of up to 55% for breaching this limit and making withdrawals."

Claire van Rees is a partner at Sackers, a specialist law firm for pension providers, trustees, employers and corporate investors. She believes that taking drastic action to avoid exceeding the LTA may not be the right option.

"Stopping your pension contributions if you're close to the LTA won't necessarily be the best financial decision," van Rees says, explaining that this could mean that you'd lose out on employer contributions to a DC pension arrangement, while those in DB schemes could be better off building up pension benefits and paying the LTA tax charges. But, again, everyone's personal financial circumstances are different, so it's important to seek expert guidance if you're considering this course of action.

DB pensions are tested against the LTA by multiplying them by 20, so someone could have a DB pension of about £50,000 without exceeding the current LTA, she says. But it would cost someone with a DC pension a lot more than £1,073,100 to buy a guaranteed income of £50,000 from an insurance company, as annuity rates have fallen a lot over recent years.

The last word should go to Baroness Altmann, who was minister of state for pensions when the LTA was at its lowest level. Now an expert commentator for the industry network Pension Playpen, she says: "It is very difficult to protect against the LTA because one cannot predict investment performance. In a DB scheme, this might mean retiring early to ensure the calculation basis is fixed now. But then that prevents all ongoing pension accrual and has done damage to the NHS too. In the end, if there is a generous employer contribution and higher-rate tax relief, it may still be worth incurring an LTA charge." ●

> **"Stopping your pension contributions if you're close to the LTA won't necessarily be the best financial decision**

THE FACTS OF LIFETIME ALLOWANCE

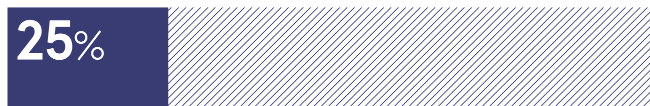
Gov.uk, *International Investment*, 2021

The current lifetime allowance

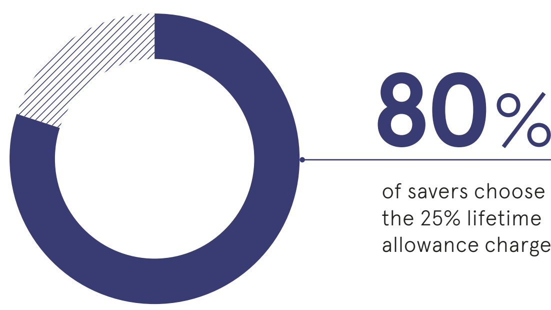
£1,073,100

Current tax rates on the lifetime allowance:

as a lump sum



any other way (ie, pension payments or cash withdrawals)

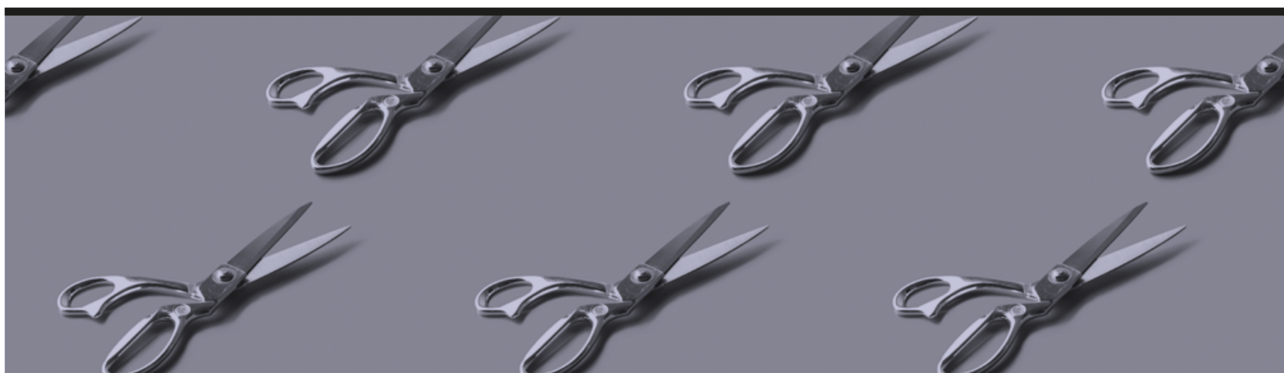


80%

of savers choose the 25% lifetime allowance charge

£283m

the total value of lifetime allowance charges in 2018-19 (a 6% increase on 2017-18)



How can I protect myself?

If you think your pension fund might breach the LTA, you can apply to the government for protection.

There are two types of protection. Fixed protection 2016 allows you to fix your LTA at £1.25m under the condition that no further pension contributions can be made. Individual protection 2016 is for people whose pension was worth more than £1m when the LTA was cut. You can continue to save, but you may have to pay tax when you take your pension benefits.

	What it does	May I keep building up my pension?
Individual protection 2016	Protects your LTA to the lower of: • The value of your pension savings as at 5 April 2016. • £1.25m.	Yes, but you must pay tax on money taken from your pension savings that exceed your protected LTA.
Fixed protection 2016	Fixes your LTA at £1.25m.	No, except in limited circumstances. If you do, you'll: • Lose fixed protection 2016. • Pay tax on the value of your pension savings used that exceed the standard LTA when you take your benefits.

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