First Actuarial Briefing for Trade Unions
Q1 2019

Introduction

Welcome to the latest edition of our briefing for trade unions. In this issue, we'll look at the following topics:

- 2019 Annual Funding Statement
- Pension lump sums withdrawals greatly over-taxed
- Investments: Environmental, Social and Governance funds
- Pension protections ruled as discriminatory
- Pensions Fun Fact!

2019 Annual Funding Statement

In the latest Annual Funding Statement, published in March 2019, The Pensions Regulator (TPR) outlined how it expects trustees to manage the risks relating to their defined benefit pension schemes.

Some of the main features include:

- putting in place a long-term funding target that reflects a scheme's ultimate target (for example, for closed schemes that might be running on without needing to go back to the employer for further contributions, or buyout with an insurance company);
- focussing on the length of recovery plans, with a clear steer towards a maximum of 7 years for a lot of schemes; and
- consideration of the disparity between deficit contributions and dividend payments.

Pressure from TPR to meet deficits more quickly and to budget for higher funding levels may well mean more employers will look to close their defined benefit schemes. Unions should be alert to this, and take appropriate action where necessary.

Pension lump sums withdrawals greatly over-taxed

On 6 April 2015, Government introduced 'Pension freedoms' which gave people greater flexibility in how they accessed their pension "pots".

Members of defined contribution schemes no longer had to use their pension pot to buy an annuity (a guaranteed income for life). Instead, members were given the flexibility to take their pension pot as they liked, including as a one-off, or series of, lump sums.

When members access their pension savings in this way, 75% of each lump sum is liable for income tax, with the pension provider having an obligation to pass the deducted tax amount to HMRC.

Most pension providers do not know the most up to date tax code for each scheme member. So, when a member wants to withdraw a lump sum from their pension pot, HMRC instructs pension providers to use a temporary income tax code, known as an emergency tax code. The problem is that under an emergency tax code the amount being withdrawn is treated as if it will continue to be paid each month even though it may actually be a one-off amount. This is likely to result in an overpayment of tax. Figures released by HMRC suggests that from October 2018 to December 2018, £30m in overpaid tax has been reimbursed to pensioners. Since the introduction of pension freedoms, a total of £400m in overpaid tax has been reimbursed.

To reclaim the overpaid tax members need to write to HMRC. However, there is growing concern that not everyone is aware of this, or even aware that they may have been over taxed.

Investments: Environmental, Social and Governance funds

Under new rules, published by the DWP (Department for Work & Pensions) in September 2018, pension schemes with over 100 members will now have to show how they've considered Environmental, Social and Governance (ESG) factors in their Statement of Investment Principles (SIP).

What is ESG?

A well-run company will incorporate ESG factors into its business model. The main features of ESG are:

Environmental:

- How a company's actions impact the environment
- How environmental changes may impact a company

Social:

- Gender equality and fair pay
- Recognition of trade unions

Governance:

- Selection of directors
- Executive remuneration and approach to taxation

Reasons why ESG factors matter

Aside from the ethical implications, trustees and trade unions should consider the sound investment reasons for allowing for ESG factors in a scheme's investment strategy. For example:

Environmental. If other companies start adapting their investment strategies by reducing their investments in carbon-heavy companies, trustees should consider whether they are comfortable holding on to large investments in such firms.

Social. Socially irresponsible companies could see their share price fall because of negative media portrayals as did Volkswagen when it tampered with the results of pollution emissions tests.

Governance. If a firm's corporate governance structure is up to the mark, it is more difficult to mask large scale fraud such as the recent Patisserie Valerie accounting scandal.

When do these rules come into effect?

From October 2019, trustees will be required to justify to members why they have not considered ESG factors when reviewing their long-term financial investments.

Trustees and trade unions will need to investigate whether their scheme is affected by the new legislation, and to what extent the scheme's investment strategy should take into account ESG matters.

Pension protections ruled as discriminatory

Background

In 2015, changes were made to all public service pension schemes in an attempt to make them more affordable and to reflect the recommendations set out in the Hutton review. Benefits earned from 1 April 2015 are calculated on a Career Average Revalued Earnings (CARE) rather than a final salary basis, with normal pension ages aligned with State Pension Ages.

For members close to retirement (by definition, older members), transitional protections were put in place to allow them to remain in their existing scheme for longer (in many cases until they retired). Younger members started to build up benefits in the new schemes immediately.

In December 2018, the Court of Appeal ruled that the Government had discriminated against younger members when allowing for these transitional protections for members of the firefighter and judicial schemes. This judgement could also affect other public service pension schemes, including the Armed Forces, NHS, Civil Service and Teachers.

What happens next?

Government is seeking permission to appeal this decision. If they are unsuccessful, they will need to make sure that any discriminatory elements are removed. The cost of this has been estimated to be around £29.5 billion per annum.

A significant issue is that different members will be affected in different ways. For some, being protected by remaining in a final salary scheme for longer might be less beneficial during a period of flat salary increases than moving to a CARE scheme. So it might be necessary to give all members the better of a protected and unprotected benefit.

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Pensions Fun Fact!

In our last briefing, we asked… Which of the following countries offers the most generous pensions and which the least generous (measured as a percentage of working wage at retirement)?

Turkey	Italy	Netherlands	Portugal	UK	Croatia	India

Answer to Q4 2018: Most generous: Croatia Least generous: UK

Question Q1 2019: Which of the following two countries have the highest and lowest life expectancies, according to the World Health Organisation?

Highest:	Japan	Poland	Greece	Brazil	Croatia	Russia
Lowest:	Sierra Leone	Ghana	South Africa	Chad	India	Angola

Further Information

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We welcome feedback on any of the issues covered and suggestions for issues that should be covered in the future. If any of your colleagues would like to receive future briefings but are not on our circulation list, please email alexandra.cherouvim@firstactuarial.co.uk and they will be added to the list.

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