first actuarial

First Actuarial briefing for trade unions Q2 2023

In this issue we review the proposed changes to the State Pension age and the secondary effects of last year's market turmoil.

We also discuss the impact of the Capita cyber attack, The Pensions Regulator's (TPR) new Liability Driven Investment (LDI) guidance, and fairness to members in times of changing market conditions.

Can Government justify State Pension age rises?

An individual's State Pension age (SPA) is the earliest age at which they can start to receive their State Pension. The timing of any increase to the SPA is set out in legislation but is reviewed at least every six years by Government. In October 2020, the SPA increased to age 66 for those born on or after 6 October 1954. Under current legislation, it will increase further for younger cohorts to age 67 between 2026 and 2028 and to 68 between 2044 and 2046.

At the last review of SPA in 2017, Government said it intended to bring forward the SPA increase to age 68 from 2037–39, although it would carry out the next SPA review before legislating. Having just done this, it now says there will be another review within two years of the next parliament to "reconsider the rise to age 68". Life expectancies have been increasing, but at a slower rate than expected. According to a report by the Government Actuary published earlier this year, the projected life expectancies at retirement for the UK population have reduced by over two years since the previous SPA review in 2017.

Back in 2017, the Government set a long-term target that up to 32% of adult life should be spent in retirement. There had been an expectation that increasing life expectancy would push up the SPA to maintain this proportion. But in his report, the Government Actuary assessed that the increase in SPA to age 67 could be delayed until 2037-39, and the increase to age 68 delayed to 2053-55 with this proportion still being maintained.

Despite the Government Actuary's report, the Government has concluded that the plans to increase the SPA to age 67 remain appropriate.

It's also worth remembering that the impact of Covid-19 on long-term mortality is only partially known, and it will take time for the full impact of the pandemic to feed through to mortality data.

Capita cyber attack

Capita announced on 3 April 2023 that it had experienced a cyber attack. While they initially stated that there was no evidence of customer, supplier or colleague data having been compromised, a further statement on 20 April 2023 said that there was "some evidence of limited data exfiltration" which "might" include customer, supplier or colleague data.

According to press reports, Capita, whose services include pensions administration, handles millions of people's data. They state that their understanding is that the compromised data was from "less than 0.1%" of its server estate. The Universities Superannuation Scheme (USS) has stated that Capita formally told them that hackers had accessed data relating to USS members, and that it was informing its half-million membership of the incident.

TPR has advised trustees of schemes administered by Capita to check whether their member data could be affected. Trustees are obliged to notify the Information Commissioner's Office within 72 hours of becoming aware of any breach.

Capita expects to incur costs of £15m to £20m associated with the incident.

This incident emphasises how important it is that trustees and sponsors understand cyber security risks and the actions they can take to minimise the risk of a breach in the future.

First Actuarial can run a training course on cyber security for your scheme trustees. To find out more, get in touch: https://firstactuarial.co.uk/contact-us/.

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Does your scheme deliver fair value to members?

Members of Defined Benefit (DB) pension schemes are entitled to a cash sum that can be transferred to another scheme in lieu of their defined benefits. This is known as a cash equivalent transfer value (CETV).

CETVs are linked to market conditions and are particularly sensitive to the expected returns on a scheme's assets. In recent months, yields on gilts and corporate bonds – assets commonly held by DB schemes – have risen significantly.

This means that a CETV calculated today is likely be significantly lower than one calculated a year ago. This could have implications for members beyond a lower value that could be transferred – CETVs are also used to value a member's benefits in a DB scheme as part of divorce proceedings.

The underlying set of assumptions, or 'basis', for calculating CETVs is set by a scheme's trustees. It's important for trustees to monitor and review the appropriateness of their CETV basis, in particular when market conditions have changed significantly.

Members of DB schemes are also able to give up some of their pension at retirement in exchange for a tax-free cash lump sum. The amount of cash received for each pound of pension exchanged is determined by cash commutation factors. Like CETVs, cash commutation factors are often linked to market conditions and are likely to have fallen with rising gilt yields. This means members would get a lower tax-free cash lump sum for the same amount of pension exchanged.

Many schemes only review their cash commutation and retirement factors periodically, so the factors currently in force may no longer be appropriate. In particular, some schemes fix factors for a certain period of time for administrative simplicity. This also applies to factors used to uplift pensions in cases of late retirement and those used to reduce pensions in cases of early retirement.

> Trustees should consider whether their scheme's CETV basis and factors remain appropriate given recent market movements.

TPR releases new LDI guidance

Following the gilts market turmoil in late 2022, TPR has released new guidance for trustees who invest in Liability Driven Investments (LDI). The guidance is aimed at leveraged LDI, although trustees who use unleveraged LDI may wish to apply it where relevant.

Many schemes hold some LDI, which helps reduce volatility in their funding position because their assets and liabilities should move in a similar way (also known as 'hedging'). LDI can be complex. It's important that trustees fully understand the issue so they can make informed decisions about investment strategy.

TPR stresses the importance of trustees putting in place appropriate controls and governance to mitigate the risks associated with investing in LDI. This includes having an appropriate 'collateral buffer' (used if additional collateral is needed when market conditions change) to better withstand market shocks that may occur in future. Trustees should also ensure that LDI is appropriately monitored, and that any LDI investment strategy is tested for resilience.

In breaking news, the House of Commons Work and Pensions Committee has just released its report on LDI. Its recommendations include TPR requiring trustees to report regularly on their use of LDI, improving scheme governance (including trustee knowledge), and requiring investment consultants to be regulated by the FCA.

Buy-out – Squandering alternative opportunities?

The funding level of many DB schemes has risen significantly over the past year, triggering a discussion about how schemes should react. TPR urges trustees to de-risk. However, some industry experts have called for an alternative approach.

A surplus could be used to generate value in the scheme, potentially for both members and sponsors, rather than to buy-out benefits with an insurer.

One suggestion by consultancy LCP is to add an optional addition to the Pension Protection Fund (PPF) levy, which would cover 100% of a scheme's benefits in the event that its sponsor is unable to support it. Currently, members who enter the PPF can lose part of their benefits including some pension increases.

Using surpluses to pay immediate discretionary increases might be more helpful to members amid a cost of living crisis.

FCA urges trustees to report dubious transfer requests

The Financial Conduct Authority (FCA) has published a web page which trustees can use to report pension transfer requests when they have carried out checks and have serious concerns. The FCA would like to hear about any known or suspected pension scams as well as various other concerns, including:

- An individual providing unauthorised advice on pension transfers
- Cases where a member has been offered an incentive to transfer their pension
- Requests to transfer to schemes with high-risk, unclear or unregulated investments, or high or opaque charging structures.

Find out more on the FCA web page.

Pensions fun fact!

In our last briefing, we asked…

Question for Q1 2023:

The Chancellor has increased the full Annual Allowance from £40,000 to £60,000. But what was the Annual Allowance when it was introduced in 2006?

£40,000 £60,000 £215,000 £255,000

Answer to Q1 2023: £215,000

Question for Q2 2023:

The earliest a person can start taking money from a pension (excluding ill-health circumstances or where a member has a protected pension age) is age 55, rising to 57 from 6 April 2028. But what was the minimum age before it was set at age 55?

45 50 53 No limit

How First Actuarial can help

First Actuarial is a nationwide firm of pensions actuaries and consultants. We support trade unions with all their pensions issues.

We help trade unions to negotiate with employers, lobby government, resolve problems within specific schemes, and explain any changes or choices members have to make.

We also provide administration, actuarial and investment services to a large number of trade unions' own schemes.

If you or any of your colleagues would like to receive future briefings but are not on our circulation list, please visit our preference centre to sign up. Under the topics of particular interest banner, select *Pensions for Trade Unions*.

We welcome feedback on any of the issues covered and suggestions for issues that should be covered in the future.

If you'd like more information on any of the issues contained in the briefing, please contact:

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