Briefing note

Corporate pensions hot topics – H1 2022

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Here are the corporate pensions issues that we expect will be key priorities over the next 6 months:

1) New regulatory powers

The Pensions Scheme Act 2021 has introduced a range of new regulatory powers**,** including:

- Two new criminal offences, relating to conduct (including failure to act) that either avoids an employer debt or has a materially detrimental effect on the likelihood of accrued benefits being received. These offences are based on existing contribution notice grounds but are much wider – they can apply to almost anyone whose actions relate to or affect a pension scheme, not only employers and those associated or connected with them.
- New discretionary civil penalties up to £1m on similar grounds to the new criminal offences.
- Two new grounds for issuing contribution notices. These grounds are:
    - if a section 75 employer debt had hypothetically fallen due as a result of employer insolvency immediately after an act or failure to act, the act or failure to act would have materially reduced recovery of that debt; and
    - the act or failure to act reduced the employer's resources by an amount that is material relative to the estimated section 75 employer debt.
- An accelerated regime (expected to come into effect in April 2022) for notifying and engaging with pension scheme trustees and TPR in relation to specified corporate activity, with the requirement to submit an “accompanying statement” to the trustees and TPR setting out the implications for the scheme of the transaction and how any potential detriment will be mitigated.

Key takeaway – review your corporate pension governance processes to manage the increased regulatory risk. Consider and manage the impact on your DB scheme when planning any significant corporate activity.

2) Triennial valuations

If you have a March/April 2022 triennial funding valuation, these are likely to be the key issues:

- Integration with the new funding regime – a new DB funding regime is coming in late 2022 or 2023 but will not apply to March/April 2022 valuations. You’ll need to consider the extent to which you align such a valuation to the expected new regime, and any broader ‘end game’ discussions (see next section).

- Impact of RPI reforms – with RPI trending down to CPI from 2030, market-implied RPI and CPI appear to be over-stated, with investors paying a premium for inflation protection. Both inflation assumptions, and particularly the level of any inflation risk premium, will need careful thought for 2022 valuations.
- Life expectancy – the longer term impacts of Covid-19 on longevity remain unclear, meaning the life expectancy assumption needs particular care.
- Contributions versus dividends – the Pensions Regulator has renewed its drive for parity in the treatment between shareholders and pension schemes. It is therefore unlikely you will be able to agree a low level of contributions if you're paying material dividends to shareholders, unless you have a very well funded scheme.

Key takeaway – make sure you are on the front foot in valuation discussions - develop your strategy before the valuation date and engage early with the trustees.

3) End game planning

Most DB scheme trustees and their advisers are seeking to map out the journey of their scheme from today through to its end. This requires a wide-ranging dialogue that covers funding, investment, risk transfer and operational project planning. It is essential that companies properly engage – ideally, they would drive these discussions, which should also include any DC trust-based assets. A passive approach will lead to sub-optimal corporate outcomes.

Even when the end game strategy has been agreed, it is important that the company and trustees continue their joined-up approach, and monitor the strategy and new developments as they unfold.

At the same time the pensions industry expects the first superfund transactions to happen very soon. We are also seeing innovative capital-backed risk transfer solutions emerging in the market, which offer a lower cost solution to a traditional buy-in/out by leaving some risks with the sponsor and members for a period of time. For the right situation these developments could be a valuable addition to the company "toolkit" when setting the end game strategy, but only if they are well understood.

Key takeaway – take the lead on end game discussions with your trustees, make sure your governance processes are fit for the purpose of monitoring and controlling the strategy as it unfolds and take time to understand the potential relevance of new risk transfer solutions.

4) Pension accounting

Be prepared for continuing high levels of auditor scrutiny at the 2021 year-end, following the FRC's review of the big 4 accountancy firms. Some changes and specific areas of auditor focus are around:

- Needing individual assumptions to be acceptable, not just the overall package of assumptions
- Requesting more granular data - it is therefore important to have upfront conversations between the auditor, company and trustees about this
- IFRIC14 - whilst there is nothing new to report on IFRIC14 itself, as more schemes head towards an accounting surplus, this could become an issue for companies who have not had to consider IFRIC14 in the past
- Increased scrutiny of actuarial models and processes.

In terms of assumption-setting, the key areas for debate are the same as highlighted earlier for funding valuations, namely the level of RPI/CPI and mortality assumptions, although there are arguments for landing in different places on these assumptions for funding valuations and accounting. In addition, current high levels of both RPI and CPI could lead to significant experience losses for the 2021 year-end.

Finally, if the company and trustees are considering their scheme's endgame strategy or a specific risk transfer transaction, companies need to make sure they are aware of the potential accounting impacts of planned de-risking. In particular, you should be clear on the impact of transacting a series of buy-ins over a period of years, as compared with one large buy-in/buyout at the end of the scheme's life.

Key takeaway – be on the front foot with your auditors as the year-end approaches, so that any additional areas of auditor focus are clear in advance and can be dealt with efficiently, without undermining the timescales by which you need results.

5) GMP equalisation and member options

The trustees' deliberations about how to equalise for unequal GMPs should not be carried out in a vacuum – in particular, it will be very challenging in future to offer pension increase exchange (PIE) (or to continue to offer a PIE option at retirement) if the trustees are intending to equalise via a dual records approach.

The need to reconsider RPI and CPI assumptions for accounting and funding valuation purposes is also just as crucial in the context of member options (e.g. transfer values and PIE). In particular there is a strong corporate argument for deducting an inflation risk premium from market implied RPI when setting member options, on the basis that investors are paying a premium to hedge inflation that should not flow through to best estimate member options terms.

Key takeaway – make sure you consider member options when decisions are being taken on GMP equalisation.

6) DC – are you getting good value?

Companies pay large amounts into their DC arrangements on an annual basis. In no other part of your business would you do this without regularly reviewing whether your spend is giving good value. When did you (or the trustees) last review your DC arrangement? If it's under £100m and trust-based, there's a lot more governance that will needed from January 2022 in order to demonstrate the value.

There is huge competition amongst DC master trusts, creating opportunities to transition trust-based assets at no cost to the members or employer and with ongoing management charges at an all-time low (and guaranteed for at least 5 years). Such transitions also typically deliver enhanced services from the provider. In a recent example, a client with £500 million of assets was able to transition to a sustainable default strategy and launch a new engagement and wellbeing campaign, whilst seeing their charges reduce by 50%.

Key takeaway – it is a golden time to review your DC pension vehicle and strategy.

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