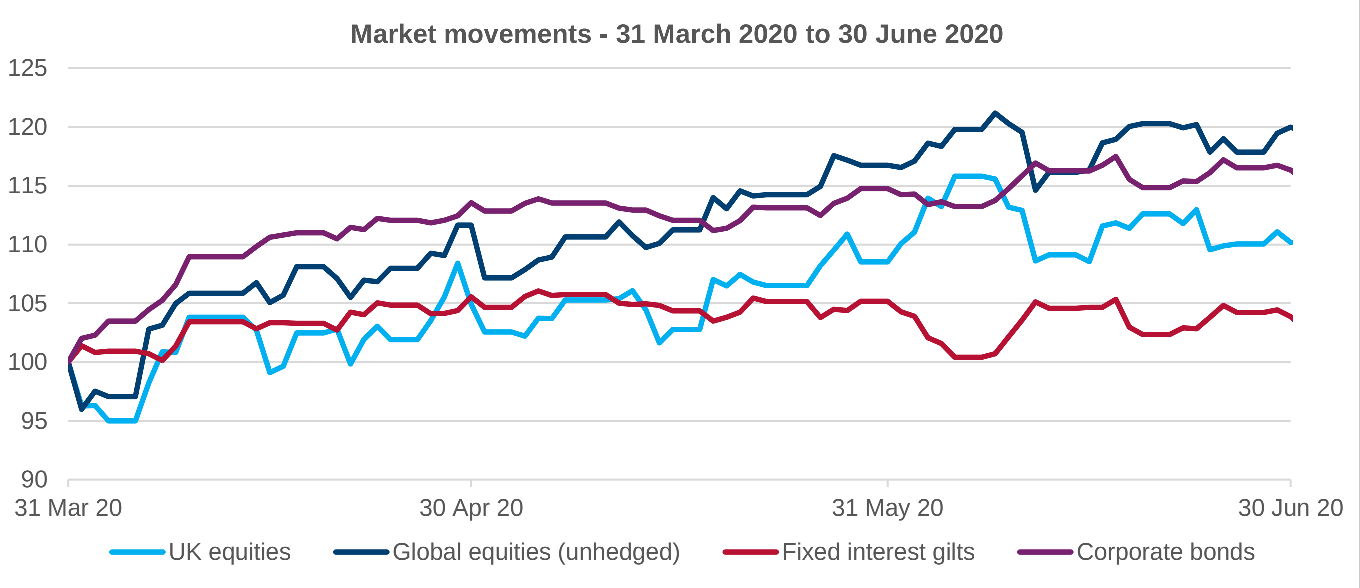
Employer Pension Briefing, Quarter 2 2020

What were the key pension issues for employers in the second quarter of 2020? In this briefing, we look at funding level improvements in Defined Benefit (DB) schemes, the new interim regime for DB superfunds, The Pension Regulator's annual DB funding statement, and a ban on independent financial advisers charging for pensions transfer advice on a contingent basis.

Assets rally in Q2

Following the falls in growth assets during the first quarter of 2020, assets have rallied. All the major asset classes produced positive returns over the quarter; with global equities were the best-performing asset class.



The impact of market movements over the quarter on company balance sheet positions will be mixed. DB pension accounting liabilities have increased significantly, and whether your scheme's assets have kept pace will depend on the investment strategy and contributions in place. The table below shows the change in key pension accounting liability metrics over the last quarter and year.

	30 June 2019	31 March 2020	30 June 2020
Corporate bond yield[1]	2.25% pa	2.31% pa	1.45% pa
Implied RPI inflation[2]	3.62% pa	3.05% pa	3.28% pa

1) iBoxx over 15 year £ AA corporate bond yield
2) Market implied RPI inflation for a duration of 20 years

Looking at the changes since 30 June 2019, corporate bond yields (and hence accounting discount rates) are down by around 0.8% pa, while future expectations of inflation are around 0.3% pa lower. This means your Defined Benefit Obligation (DBO) may have increased by as much as 15% since 30 June 2019.

TPR launches tough interim regime for superfunds

The Pensions Regulator (TPR) has issued interim guidance on the regulation of superfunds, which came into force on 18 June 2020. This long-awaited guidance will now allow the likes of Clara-Pensions and The Pension SuperFund to seek approval from TPR to operate.

TPR admits they have set the bar high. Schemes entering a superfund must seek regulatory clearance and follow prescribed methods for calculating liabilities. Capital buffer requirements form part of the guidance, and superfunds will not be allowed to withdraw capital during the interim period.

One benefit for sponsors of DB schemes is that a superfund provides an alternative option for severing links to their pension scheme at a price expected to be lower than the cost of securing benefits with an insurance company. However, transferring to a superfund will only be possible if the sponsor can convince the trustees (and TPR) that it is in the best interests of members to do so. Trustees may decide that a superfund can improve member outcomes where their pension scheme demonstrates all or most of the following features:

- The covenant is weak or uncertain
- An insurance buy-out is not affordable
- The population is immature, making the superfund pricing more attractive relative to buyout
- Funding is available to meet the superfund premium.

Superfunds are an interesting development and may lead to the launch of further funds or solutions.

The end is near for contingent charging

The Financial Conduct Authority (FCA) has announced that with effect from 1 October 2020, independent financial advisers (IFAs) will be banned from charging for pensions transfer advice on a contingent basis (i.e. where their fees depend on a member opting to transfer out to a new scheme).

On one hand, this removes the potential conflicts of interest that some advisers face where they only get paid for their work if the transfer takes place. On the other hand, there are fears that members will be less likely to seek advice if they have to pay for it upfront (rather than through a charge on their pension saving). This change could also lead to a shrinking IFA market (which could make advice more expensive and harder to find).

First Actuarial monitors and researches IFAs that provide specialist DB to DC (Defined Contribution) transfer advice. Within this segment of the IFA market, contingent charging is already relatively rare. However, it is welcome news that best practice is being made mandatory in this area.

DB scheme funding and investment

On 30 April 2020, TPR published its latest annual funding statement and in early June 2020, TPR updated its guidance on the funding and investment issues around Covid-19. These documents are essential reading for trustees and employers currently carrying out actuarial valuations or amending their funding strategy due to the impact of Covid-19.

Our Employer Services team helps employers with funding and investment strategy negotiations. Get in touch with one of our team to discuss your current situation. You might also find it useful to watch our video for employers considering their actuarial valuation results.

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