Pensions in 2021

Following the tumultuous year that was 2020, the pensions industry may be hoping for a quieter 2021. However, with the impact of Covid-19 still being felt, the introduction of the Pension Schemes Bill and a swath of new regulations, this seems unlikely. Jack Gray looks ahead at the trends likely to shape the coming year

Introducing the Pension Schemes Bill

With the Pension Schemes Bill achieving royal assent, professionals across the pensions industry are going to have to adapt to all the changes it will bring. Schemes will need to prepare for the introduction of pensions dashboards and increased reporting and action on climate risk, and familiarise themselves with The Pensions Regulator's (TPR's) new powers, among many other changes.

"The act will be followed up by a raft of detailed secondary regulation in early 2021," comments Aegon head of pensions, Kate Smith.

"This includes new transfer regulation setting out prescribed transfer scam red flags, which if raised will remove member's statutory right to a pension transfer.

"In addition, the Department for Work and Pensions (DWP) will be publishing regulations setting out how the largest occupational pension schemes will have to report their carbon footprint in line with the Taskforce on Climate-Related Financial Disclosures (TCFD)."

LCP partner, Jonathan Camfield, notes that TPR will publish guidance on how it intends to use its new powers in 2021 and there are two new contribution notice powers that the industry will need to learn how to navigate.

"Many companies and trustee boards will need to review their governance procedures to ensure they comply with the new requirements," he continues. "Some will also be surprised that previously considered 'normal business activity' may trigger the new rules, leading to a need to compensate a pension scheme in the context of refinancing, dividend payments or restructuring.

"By the end of 2021, I expect company boards will be treading more carefully when it comes to any business activity that could impact the strength of the business that supports the pension scheme."

Camfield adds that although it could be argued this change will be good for schemes, he questions whether the shift towards greater support of scheme at the expense of other company stakeholders may unnecessarily hurt businesses when the economy is coming to terms with the fallout of Covid-19 and Brexit.

Covid-19 fallout

The year 2020 was dominated by the unprecedented crisis of Covid-19. Although vaccines have been approved and there is light at the end of the tunnel for many, there are concerns its impact has not yet been fully felt and sponsors are still at risk.

"In many ways, the full impact of the Covid-19 pandemic for the pensions world is yet to fully emerge," says LCP partner, Steve Webb. "Insolvency rates in the earlier part of 2020 were actually below normal levels, but as government support schemes unwind, insolvency levels are likely to rise substantially in 2021 and beyond.

"Trustees in particular will face difficult judgements as to how far to give corporate sponsors the breathing space on contributions to get their businesses back up to speed and how far to press for money for the pension scheme now."

PLSA director of policy and research, Nigel Peaple, concurs: "The recent collapse of Arcadia and Debenhams has put the spotlight on DB funding and sadly there may be more businesses which succumb to financial pressure."

SEI head of institutional group for EMEA and Asia, Ian Love, adds: "The ramifications of Covid-19 will continue to impact the economy in 2021 and the pensions industry will not be immune to the economic upheaval.

"Pension schemes and their investment portfolios will continue to experience significant disruption, and the scars inflicted in 2020 will take time to heal."

However, Love notes that the pandemic has also unearthed "hidden efficiencies" for pension schemes, such as increased technology adoption.

Insight Investment head of solution design, Jos Vermeulen, notes that, as pension schemes manage their interest rate and inflation risk, and they move out of equities, the longevity risk starts to become a larger part of their remaining risk.

Brexit stage left

The pandemic has somewhat overshadowed one of the biggest upheavals in the UK in a generation – the country's departure from the European Union. Despite the inevitability of the huge impact it will have on all financial aspects of people's lives, including pensions, there is uncertainty as to how and to what extent it will affect the industry.

"Brexit will be a consistent, industry-wide concern that will rise to and remain at the top of the agenda in 2021," says Love. "There are real question marks over how it will play out, most pressingly, its impacts on currency, rates and inflation. These will be major concerns for both DB and DC trustees."

Whatever the ramifications of Brexit, it is yet another thing for the pensions industry to adapt to in 2021.

Regulation, regulation, regulation

In 2020, TPR began consulting on its new DB funding code. It proposes a new 'twin track' approach to DB scheme funding, with its second consultation expected to launch in mid-2021.

"2021's second consultation of the DB funding code from TPR will be at the forefront of the industry's mind," comments Love.

"Against the backdrop of a weakened economy, regulation is emerging as a key pressure point for 2021 and more stringent action may potentially make some businesses, and their support for their pension schemes, unsustainable."

Webb explains that a "key decision" for regulators will be how far to press ahead with a tougher funding regime designed in more normal times, or whether to put that new approach on hold until the post-Covid economic backdrop becomes clear.

Vermeulen adds: "People are worried that it is going to overburden sponsors, but the thinking of TPR that you need different regulation on pension schemes when they are in decumulation compared to accumulation does make sense."

The age of the master trust

This year, TPR's supervision cycle on DC master trusts begins, where it will be checking that master trusts are continuing to meet the standards set by the authorisation criteria and intervene if necessary.

"In this new environment master trusts will have to prove they are financially sustainable and well run, by providing a whole host of 'mini-authorisation' information to TPR letting it see everything under the bonnet," Smith notes.

"Some master trusts will be moving from strength to strength, while others may be falling behind. As master trusts and TPR gear up it's important that open dialogue is a prerequisite with a deeper understanding that all master trusts are different, but financial sustainability should be the central priority in these uncertain times. This will be another steep learning curve for TPR, which will find out how master trusts have fared during and after the pandemic."

LCP principal, Philip Audaer, adds that too many master trusts are chasing an "ever-diminishing" pool of clients: "The DWP consultation on scheme consolidation for existing own-trust schemes with less than £100 million funds under management will create a short-term spike in demand, but after that, it's only the largest master trusts that will survive."

Audaer notes that the number of small pots is set to increase "dramatically" and master trust boards can expect to come under increased pressure from TPR to justify their delivery and independence.

Saving the world

The year 2020 saw a significant change in attitude and increased focus on pension schemes' role in the fight against climate change, and it looks like this trend will continue in 2021.

"Climate change as an issue will continue to rise up the agenda in the UK given the context of the COP climate talks taking place in Glasgow in November 2021," predicts LCP head of responsible investment, Claire Jones. "The DWP will be firming up its proposals for large schemes to report in line with TCFD early in 2021 and by October, schemes with net assets of £5 billion or more are expected to need to have a climate governance system in place, based on the DWP's current proposals.

"Expect more DC schemes to incorporate a climate or environmental, social and governance (ESG) tilt in their default strategy, some high-profile announcements of schemes setting net zero targets, and increasing interest in allocating money to climate solutions.

"When it comes to responsible investment more generally, there will be increased focus on stewardship and greater consideration of members' views on ESG topics." Peaple describes schemes' responses to the climate crisis as possibly "the most transformative innovation of the next decade".

He continues: "While schemes aren't required to apply TCFD standards until October 2022, as they gear up for regulatory change expect trustees to be very focused on climate risk over the next 12 months.

"Pension schemes cannot resolve these global challenges alone if they are to deliver the change that is necessary. The PLSA anticipates a focus on achieving a more system-wide approach emerging in 2021."

Balancing the books

As the UK comes to terms with the cost of the Covid-19 pandemic, cutting pensions tax relief has again been mooted as an option to raise some much-needed funds in 2021.

"There have been rumours that Chancellor Rishi Sunak is considering a move to a flat rate of relief, perhaps at 25 per cent," states Aegon pensions director, Steven Cameron. "While this would reduce the incentives for higher-rate tax payers, it would actually improve the boost basic-rate taxpayers receive.

"But as previous chancellors have discovered, such changes are highly complex to implement, particularly for DB schemes or for those using 'salary sacrifice' to pay their pension contributions."

"Pensions tax relief is one area that is said to be 'under review' by the Chancellor," adds Peaple. He warns that people are not saving enough currently and cutting tax relief would make this position worse.

"We fear that introducing such a major change to the retirement saving system undermines confidence in pensions which, given the long-term nature of pension saving, is harmful and counterproductive, as it is extremely unlikely to raise more than a fraction of the £40-£50 billion often quoted," he concludes.

Written by Jack Gray