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Industry Update:

The UK Government's Autumn Statement 2016

Philip Hammond, the relatively new Chancellor of the Exchequer, painted a picture of a relatively fast growing economy with low unemployment, albeit with lower tax revenue than expected and rising total government debt until 2017/18.

The Government is no longer seeking a budget surplus by 2019/20 but remains committed to returning public finances to balance as soon as practicable within the next Parliament (ie before 2025). There was also a lot of focus on increasing productivity and Hammond promised significant spending on infrastructure (eg borrowing £23 billion to invest through the new National Productivity Investment Fund) in an effort to tackle the UK's 'shocking' productivity gap with other countries.

To great fanfare, Hammond abolished the Spring Budget and the Autumn Statement, only to replace it with an Autumn Budget and Spring Statement. Although, he did promise that any significant tax and spending changes would generally only be announced in the Autumn Budget, which should allow people a bit more time before the next tax year starts to make any preparations needed.

There were a wide range of detailed tax and spending announcements, the implications of which will be analysed over coming days, weeks and months. However, the key announcements applicable to UK pension schemes that we noted are listed below:

Key pensions-related announcements

- The triple-lock pledge will be maintained until 2020, so increases to the basic state pension will continue to rise annually at the higher of inflation, average earnings or 2.5%.
- Tax breaks through certain salary sacrifice options will be eliminated; however pensions saving will be excluded from this change, at least for the time being. Hammond stated that paying less tax as a result of salary sacrifice was .
- For those members in pension drawdown the Money Purchase Annual Allowance will reduce from £10,000 to £4,000 from April 2017, to prevent inappropriate double tax relief. There will be consultation on the detail.
- The Government will consult on a ban on pensions cold calling and a wider range of pension scams, which may provide some comfort to trustees of DC schemes that are experiencing transfers out, or DB trustees that are running or considering transfer value or flexible retirement option exercises.
- Interestingly there was no further clarification on Lifetime ISAs due to be introduced from April 2017 which according to a recent PWC consumer poll many UK adults (75%) do not understand.
- There was speculation in advance that the Lifetime Allowance, or the tapering down of the annual allowance from £40,000 to £10,000 for earnings between £150,000 and £200,000, would be reviewed. Both were left untouched.

Key investment-related announcements

- Hammond reiterated that tax and government spending discipline remains important to the UK, with the only additional borrowing being in respect of infrastructure spending. This restraint should help to avoid contributing to any volatility in financial markets.
- The immediate response from financial markets (including 20 year gilt yields, £ Sterling and the FTSE100) was very limited, with the only (barely) noticeable move being a slight rise of about 0.05% pa in 20 year gilt yields. This could be due to future government borrowing, or future inflation, being slightly higher than expected due to the extra infrastructure spending. The potential impact of this on a typical DB scheme liability value is about 1%.
- Some of the Government s infrastructure spending is intended to encourage and be alongside greater private sector infrastructure investment. It is unclear at this stage what opportunities or threats this may create for pension scheme trustees. Given the generally illiquid and lumpy nature of most infrastructure projects, direct investment has not traditionally been attractive for small to medium sized defined benefit schemes. However, there may be an indirect benefit if bulk annuity insurers are able to invest in more attractive infrastructure projects and reflect this through lower bulk annuity premiums.

In addition, any DB trustees with a sponsoring employer in the infrastructure or construction-related sector, may wish to consider whether the covenant could strengthen due to the extra government spending in this area. The implications for funding and investment strategies will depend on the specific scheme circumstances.

Comment

This Autumn Statement appears to have no direct impact on how trustees operate their defined benefit or defined contribution pension schemes. This is a welcome relief from many past Budgets and Statements which tended to include sweeping changes or at least some tinkering.

Hammond will also presumably be pleased that his speech had no material immediate impact on financial markets, given the significant volatility we have already experienced this year, particularly because this is the first formal statement by Hammond since the UK voted to leave the EU. The financial markets may now focus on the next known event: the Italian Constitutional Referendum on 4 December 2016, which could lead to an Italian referendum on membership of the EU.

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