Free webinar:
Pensions : Improving your Balance Sheet and SHPS and LGPS updates

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Gweminar am ddim:
pensiynau: Gwella eich Mantolen a diweddariad ar SHPS a LGPS

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Improving your pension balance sheet and SHPS and LGPS update

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Introductions

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Who is Quantum?

An independent pension actuarial advisory firm

Five locations in the UK – Cardiff is our head office

Help employers and trustees run their pension arrangements

Services we provide include:

- Actuarial
- Administration
- Consultancy
- Investment
- Pensioner payroll
- Pension accounting services
- Flexible benefits
- Health and Wellbeing

Agenda

1. Financial accounting
    a. Background
    b. What has happened since 31 March 2020?
    c. The FRS 102 pension disclosure process
    d. How to make changes to your pension disclosures

2. SHPS and LGPS update
    a. SHPS update
    b. LGPS update

3. Pension education for employees

1. Financial accounting

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1a. Background

Financial accounting in a nut shell

- At year end date, an Association's share of their SHPS/LGPS assets and liabilities are calculated for inclusion in their financial statements
- Only applicable for SHPS employers since 31 March 2019
- A transparent method, consistent with other funded defined benefit pension schemes
- Associations are responsible for setting their own assumptions
- Result will be different to SHPS/LGPS funding valuation (method, assumptions and date)

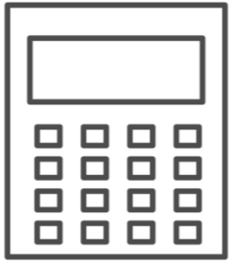
How do you carry out an actuarial valuation?

?

For benefits promised to date it is a comparison of the **present values** of:

Assets V Benefits

Simple……in theory ?!



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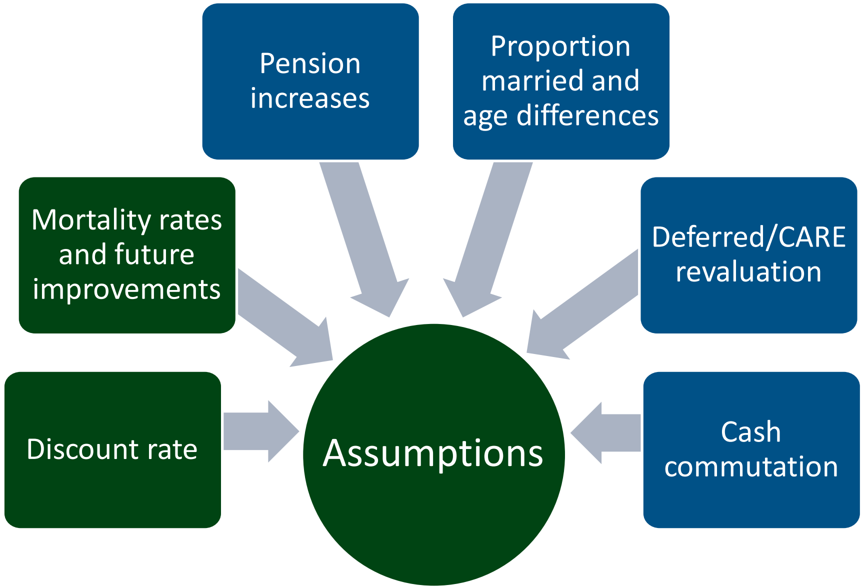
Assumptions for pension accounting



- Used to derive the value placed on defined benefit pension liabilities
- Association can decide what the assumptions will be
- Discount rate is set using the yield on high quality corporate bonds
- Other assumptions are broadly best estimate (i.e. no requirement for prudence)

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1b. What has happened since 31 March 2020?

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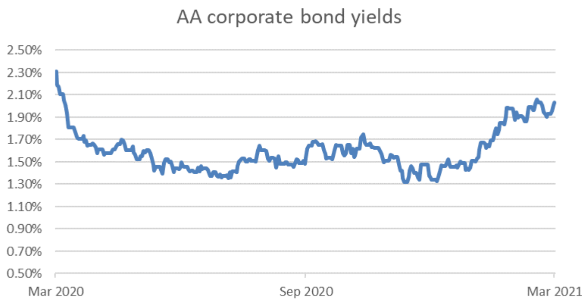
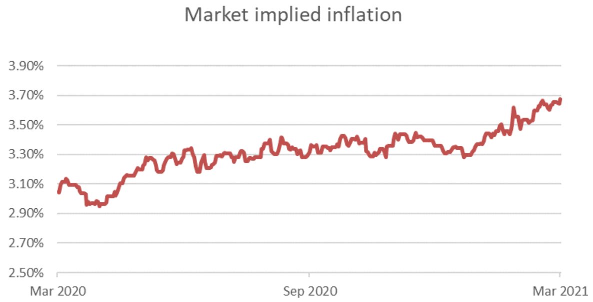
Financial markets over the 12 months to 31 March 2021





What does it mean for your FRS 102 accounting disclosures as at 31 March 2021?

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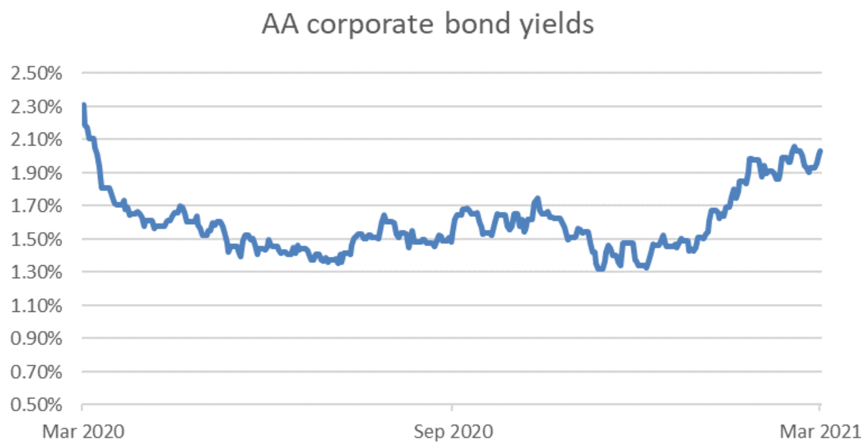
AA corporate bond yields

- This yield drives your discount rate assumption
- This assumption has the biggest impact on your pension liabilities so is the most important
- If the discount rate falls, your pension liabilities increase (and vice versa)
- A 1% fall could increase your pension liabilities by as much as 20%!



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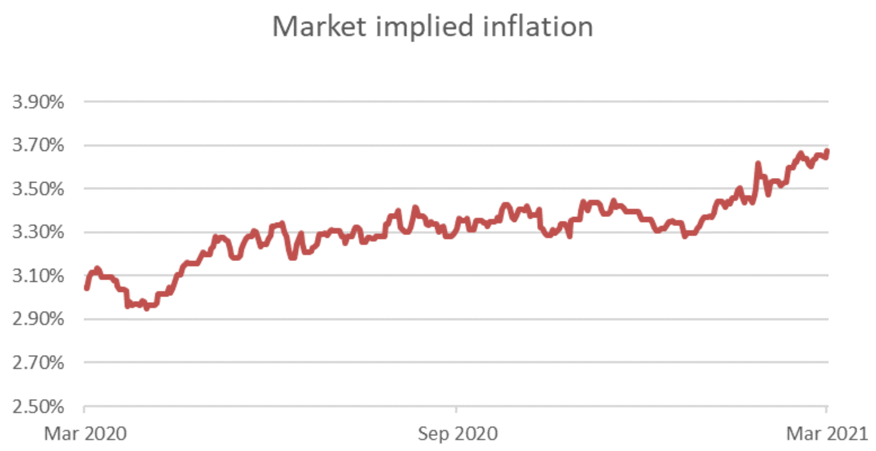
Market implied inflation

- Market's long term expectation of inflation
- Benefits before and after retirement inflation linked
- The lower the inflation assumption the lower your pension liabilities (and vice versa)
- Typically has a smaller impact than the discount rate assumption
- RPI reform to consider
- Inflation risk premiums increasing



Global equity markets

- If assets fall in value, the pension deficit (i.e. liability) disclosed on your balance sheet will increase
- Big schemes, such as SHPS and LGPS, have sophisticated, well diversified, investment portfolios
- Diversification will dampen the performance (both positive and negative) in the investment markets

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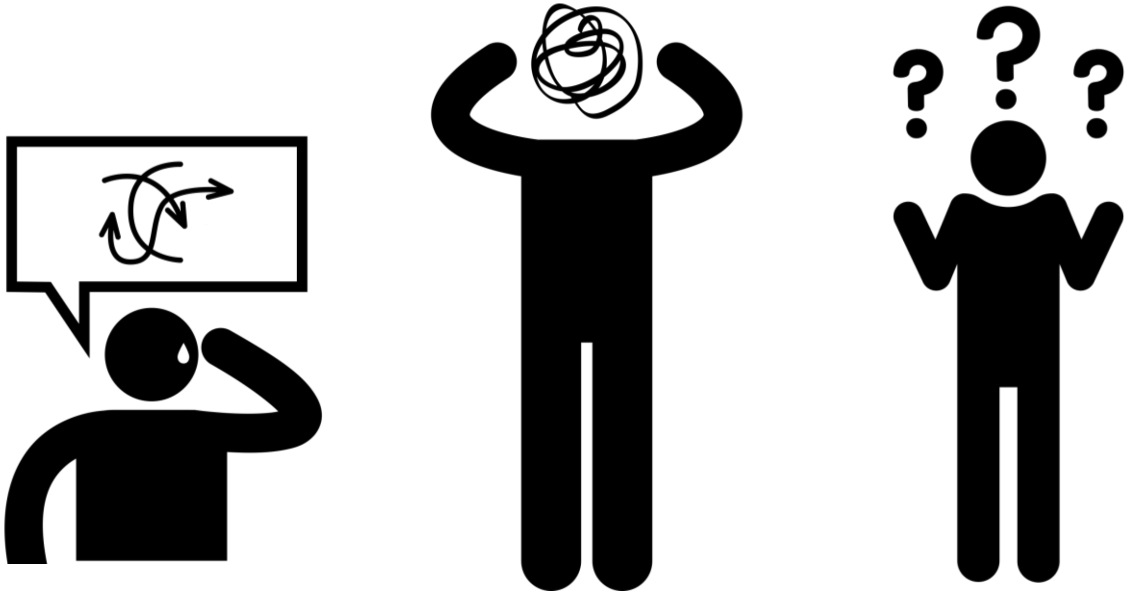
What does this mean for my pension disclosures?



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1c. The FRS 102 pension disclosure process

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The process for 2021

Provisional FRS pension disclosures for 31 March 2021 have already been provided by your actuaries, or will be very soon

Accept provisional assumptions/results **OR** Carry out a simple review

Reviews can take around 5 working days but could be quicker if needed

Make changes to the assumptions and re-run the disclosures if necessary

Disclosures can be re-run in real time for SHPS

Enter original or revised results into Association’s accounts

1d. How to make changes to your pension disclosures

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Independent actuarial advice

- Independent actuarial advice will help
  - Assess whether proposed assumptions are reasonable
  - Identify changes where appropriate
  - Assess the financial impact of these
  - Provide sufficient justification for auditors
- Impact of changes can be quite significant
- Let's look at an example showing how actuarial advice can help an employer……….

Example – proposed results disclosed by actuaries

	31 March 2021 (£000s)	31 March 2020 (£000s)
Fair value of plan assets	10,281	9,488
Present value of defined benefit obligation	14,010	12,562
Surplus (deficit) in plan	(3,729)	(3,074)
Defined benefit asset (liability) to be recognised	(3,729)	(3,074)

Based on (generic) assumptions set by the pension scheme actuary

These can be altered

These cannot be altered

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Example – proposed key assumption changes

	Proposed assumptions	Alternative assumptions (Quantum)	Approximate impact on Association's Present value of defined benefit obligation
Discount rate	2.35% p.a.	2.60% p.a.	c5% reduction
Inflation (RPI)	3.25% p.a.	3.20% p.a.	c1% reduction
Inflation (CPI)	2.25% p.a.	2.20% p.a.	
Salary growth	3.25% p.a.	3.20% p.a.	

Duration of Association's pension liabilities is 22 years. Therefore scope to increase discount rate by 0.25%

Increasing discount rate reduces the value placed on the Association's pension promises to members

As pension benefits increase in line with inflation a reduction to inflation reduces the value placed on the Association's pension promises to members

Based on our expectations of long term inflation there is scope to reduce this by 0.05%

Example – proposed key assumption changes

	Proposed assumptions	Alternative assumptions (Quantum)	Approximate impact on Association's Present value of defined benefit obligation
Cash commutation allowance	75% of maximum allowance	75% of maximum allowance	No impact
Pre-retirement mortality	Nil	Nil	No impact
Post-retirement mortality	103% of S3PxA tables relevant to year of birth, CMI 2019 projections, subject to long term trend rate of 1.5% p.a.	103% of S3PxA tables relevant to year of birth, CMI 2019 projections, subject to long term trend rate of 1.00% p.a.	c2% reduction
Overall impact	-	-	c9% reduction

Using less prudent longevity improvements

Alternative mortality assumes members do not live as long as previously expected and this reduces the value placed on the Association's pension promises to members

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Example – revised results

	31 March 2021 - revised (£000s)	31 March 2021 - initial (£000s)
Fair value of plan assets	10,281	10,281
Present value of defined benefit obligation	12,938	14,010
Surplus (deficit) in plan	(2,657)	(3,729)
Defined benefit asset (liability) to be recognised	(2,657)	(3,729)

c9% reduction

Changes reduce the Association's liabilities by £1.072m

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Final steps

Independent actuarial advice is key

Revised set of assumptions and results obtained

Need agreement from the Association's Board/Committee

Need approval from the Association's Auditor

Changes then incorporated into Association's Financial Statements

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Takeaways

- Association's responsibility to use appropriate assumptions that stand up to scrutiny
- Best practice to review provisional assumptions before adopting results
- Can result in balance sheet improvements in this year's disclosures
- Can reduce pension expense in next year's disclosures
- If provisional assumptions deemed appropriate, review can be used as justification to auditors and others

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2. SHPS and LGPS update

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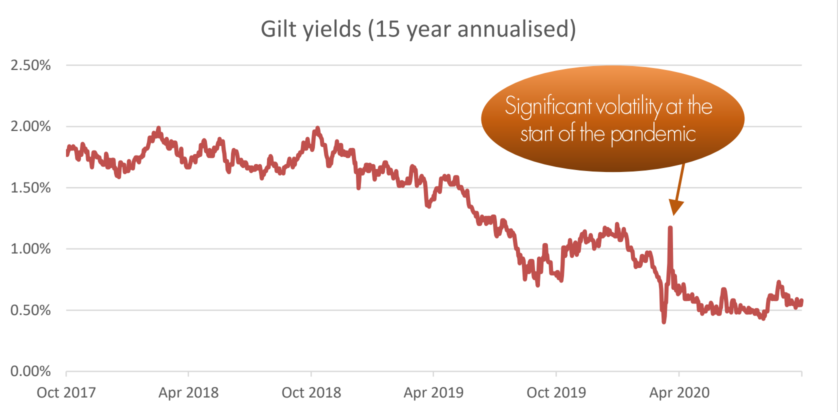
2a. SHPS update

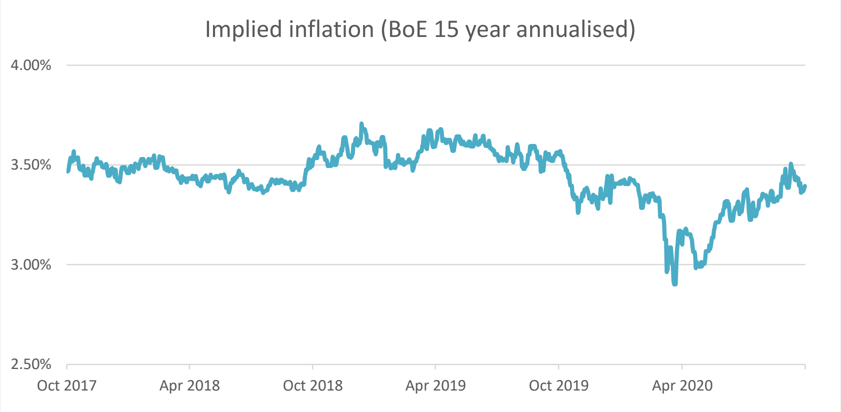
30 September 2020 SHPS valuation

What could it mean for Associations?

What could it mean for employees?

SHPS: Markets and financials between 1 October 2017 and 30 September 2020





Over the period, gilt yields have fallen by a lot more than implied inflation has decreased. This will increase the value placed on the benefits promised to members.

Over the period, investments have performed better than expected. This will have helped to improve the funding position.

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SHPS funding updates since 30 September 2017

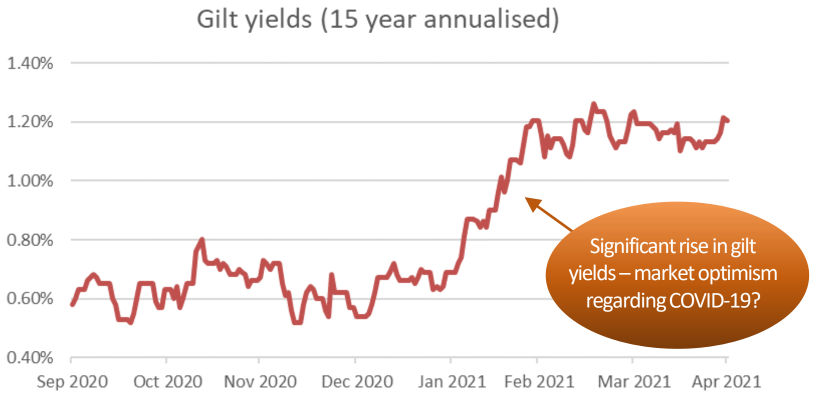
With the deficit contributions being paid expectation is for the deficit to have reduced since the last valuation

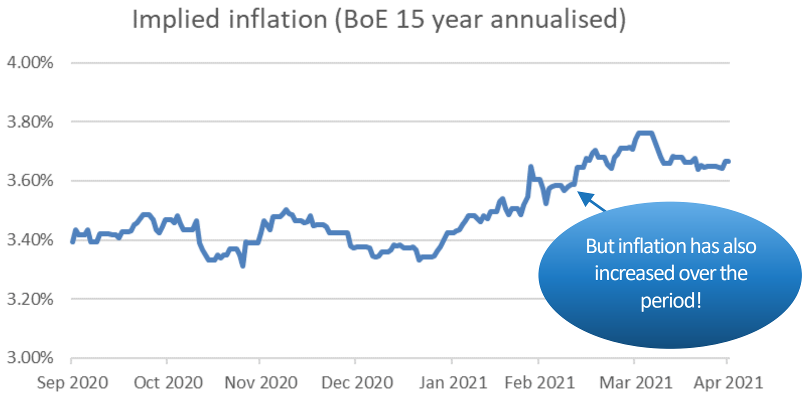
Date	Assets (£m)	Liabilities (£m)	Deficit (£m)	Funding level
30 Sept 2017	4,553	6,075	(1,522)	75%
30 Sept 2018	4,577	5,985	(1,408)	76%
30 Sept 2019	5,541	7,166	(1,625)	77%
30 June 2020	5,289	6,851	(1,561)	77%

Source: TPT

Investment markets and financial conditions did not significantly change between 30 June 2020 and 30 September 2020 therefore update as at 30 June 2020 provides a good broad indication of final outcome.

SHPS: Post valuation experience: markets and financials between 30 September 2020 and 30 April 2021





Over the period, gilt yields have increased by more than implied inflation has increased. This will reduce the value placed on the benefits promised to members.

Over the period, investments have performed better than expected. This will have helped to improve the funding position.

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Post valuation experience can be taken account of when agreeing the recovery plan

SHPS 30 September 2020 valuation thoughts

SHPS deficit of £1.5bn not reduced as per current recovery plan

Even with post valuation experience deficit contributions likely to increase

Cost of future accrual will increase too

How will Associations address the future increase in accrual costs?

Cover all of increase or share with employees?

Will SHPS DB become unaffordable for Associations and/or their employees?

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SHPS future service costs as a percentage of salary

Benefit	60th final salary	80th final salary	60th CARE	80th CARE	120th CARE
Existing rate	27.2%	20.5%	22.1%	16.7%	11.3%
Overall contribution rate assuming a 20% increase	32.6%	24.6%	26.5%	20.0%	13.6%

- Contribution rates likely to increase sometime between Q4 2021 and Q1 2022
- Associations have discretion as to what it and employees pay
- Can offer different sections - will more offer lower accrual sections e.g. 80ths and 120ths
- Consultation with employees likely to be required
- Is final salary value for money for both Associations and employees?
- Beware of debt on withdrawal if close to all DB future accrual

Start considering your options sooner rather than later

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2b. LGPS update

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LGPS considerations

In our experience 31 March 2019 LGPS valuation results were better than employers were expecting. Is this a blip or longer term trend?	• Position has certainly deteriorated since 2019 • However, we are in unusual times • Cost cap valuations
McCloud case	• Will need to be addressed by LGPS at some point • Additional liability for employers but how much?
Debt on withdrawal	• Deferred employer status • Exit payment paid over time • Still discretionary

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3. Pension education for employees

Pension education for employees

- So important
- Explain how their pension arrangements work and the options available to them
- Cost is lower than they might expect
- Life assurance too
- Benefits of paying more
- Written or face to face including virtual!
- Can be done as part of changes/consultation or in isolation
- More employers are now doing this

Questions

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