Pensions Accounting Update

As at 30 September 2024

SPENCE

Overview

This guide is a reference for companies preparing their 30 September 2024 pension accounting disclosures under FRS 102 and IAS 19.

It shows the impact of market movements over the last 12 months on both Defined Benefit (DB) pension scheme liabilities and assets. It then sets out the impact on the balance sheet position of an example pension scheme "EPS" on an accounting basis.

Over the last 12 months there has been a reduction in market implied inflation, however this has been offset by a reduction in corporate bond yields. Therefore, the impact of market movements on companies accounting bases as at 30 September 2024 will depend on the level of liability hedging present and the investment strategy of the scheme. The majority of the main asset classes had positive returns over the year, increasing asset values, with equities achieving particularly high returns. The exception to this was gilts and commodities, where a negative return was observed for each. EPS has seen an 4% improvement in its funding level over the year.

To discuss these topics further, please contact Spence through your usual contact or connect with our Corporate Advisory lead, Alistair Russell-Smith, at alistair_russell-smith@spenceandpartners.co.uk or by telephone on 020 3837 2960.

Liability Movements from 30 September 2023 to 30 September 2024

EPS Assumption	30 September 2024	30 September 2023	Change over the Year	Change in Liabilities [1]
Discount Rate	5.06% p.a.	5.44% p.a.	-0.38% p.a.	4.83%
Inflation Assumption(s)	4.15% p.a.	4.56% p.a.	-0.41% p.a.	-1.68%[2]
TOTAL[3]				**3.15%**

Discount Rate

A decrease in the corporate bond yield will result in a lower discount rate and higher liabilities, all other things being equal, at 30 September 2024.

Bond yields decreased over the first quarter of the year as expectations of further increases to the base rate set by the Bank of England decreased. Bond yields have since gradually increased until 30 September 2024.

The duration of the iBoxx over 15-year AA rated corporate bond index was 14 years as at 30 September 2023 and 15 years as at 30 September 2024.

Inflation

A decrease in gilt market implied inflation will result in a lower inflation assumption and lower liabilities, all other things being equal, at 30 September 2024.

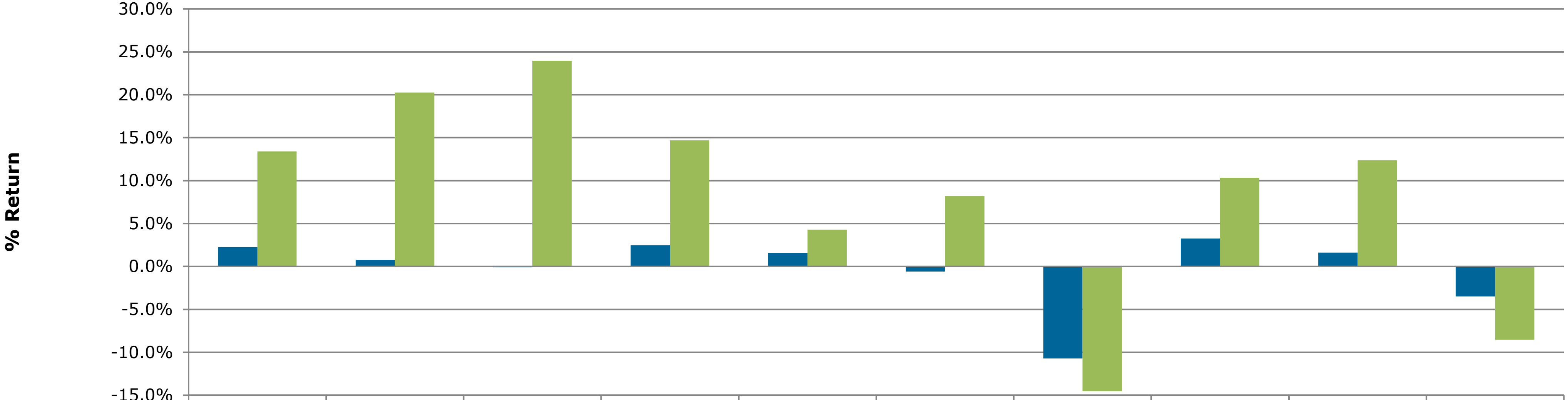
Short term expectations of future inflation increased over the year while expectations of longer term inflation decreased.

Mortality

The most recently available mortality base tables published by the Continuous Mortality Investigation ("CMI") bureau are the S4 base tables, and the CMI 2023 model. This update occurred over the year, which was taken into consideration by updating our EPS basis. The CMI 2023 (core) model applies a weighting of 15% to the mortality data from both 2022 and 2023 and, consistent with the CMI 2022 (core) model, continue to apply no weighting to mortality data from 2020 and 2021. It should also be noted that the updated CMI 2023 model uses ONS 2021 census data, which differs to previous models which used CMI estimated population data. Using the latest mortality tables should lead to a modest reduction in liabilities of under 1%.

1. Assumes EPS liabilities have average duration of 13 years.
2. Assumes the effect on liabilities of the change in inflation is a third of the effect of the equivalent discount rate change.
3. Note the approximate nature of this calculation. Each individual scheme will experience different effects on their funding level, depending on the scheme benefits and investment strategy.

Asset Movements from 30 September 2023 to 30 September 2024



	UK Equity	Global Equity	US Equity	Emerging Market Equity	Property	Hedge Funds	Commodities	Infrastructure	Corporate Bonds	Gilts
Quarter Return	2.26%	0.76%	-0.11%	2.46%	1.59%	-0.60%	-10.72%	3.24%	1.62%	-3.49%
Year Return	13.40%	20.24%	23.95%	14.70%	4.28%	8.20%	-14.52%	10.32%	12.36%	-8.53%

Chart 1 - Return on Major Asset Classes Source: Morningstar

Equities generally performed well over the year, with most markets posting returns in excess of 10% p.a.

Property achieved improved returns since last quarter, with a positive annual return.

Hedge funds posted a negative return over the quarter, but a positive return over the year.

Corporate bonds and infrastructure achieved improved returns since last quarter, and positive returns over the year.

Gilts and commodities posted negative returns over the quarter and year.

NOTES

Effect on Example Pension Scheme

Chart 2 below, captured from Mantle, Spence's award-winning integrated administration and actuarial system, illustrates the effect of market movements over the past 12 months on the balance sheet position of the example pension scheme EPS.

EPS's liabilities are assumed to have a duration of 13 as at 30 September 2024. EPS's investment portfolio reflects that of a typical pension scheme, including holdings in Liability Driven Investments and Diversified Growth Funds. EPS hedges 80% of its interest rate and inflation risk.

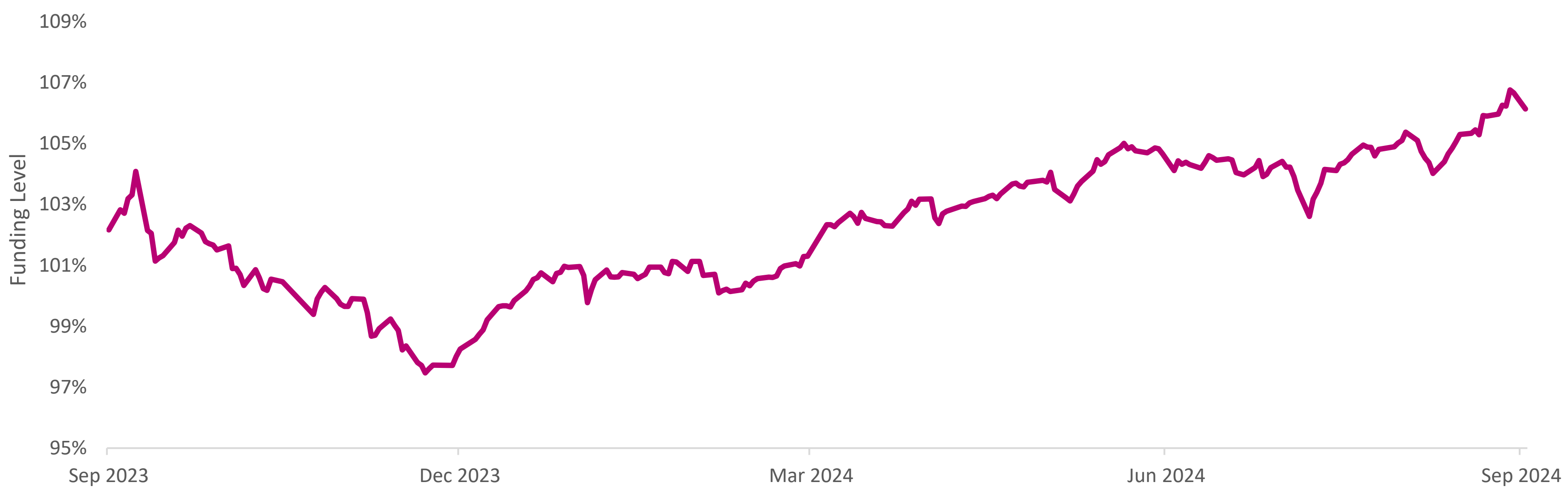


Chart 2 - Daily Movements in EPS funding level

The funding level of EPS increased by 4% over the year, this was driven by asset returns over and above the interest on the liabilities. Both discount rate and inflation assumptions increased over the year, leading to a 3% increase in liabilities.

Recent Developments

Market Conditions

The Bank of England base rate has generally been high over the past year at 5.25% p.a. although it reduced to 5.0% p.a. in August 2024 and to 4.75% p.a. in November 2024, with UK inflation continuing to fall.

Virgin Media and Section 37

On 16 June 2023, judgement was handed down in the High Court case of Virgin Media vs NTL Trustees, whereby the judge ruled that where benefit changes had been made without a valid "section 37" certificate from the Scheme Actuary, those changes could be deemed as null and void. An appeal in June 2024 was then unsuccessful. Whilst it remains possible that this issue could be addressed in the future, either by a future Court case or by DWP intervention, as it stands now this is a risk facing pension schemes. In our experience, auditors are starting to require companies to complete a risk assessment of this issue and include narrative in their accounts explaining the findings and potential exposure. Consider completing this assessment as part of your year end pensions accounting process.

CMI Model updates

The Continuous Mortality Investigation (CMI) released their Mortality Projections Model, "CMI 2023" in April 2024, to be used for financial reporting after 31 March 2024. The CMI model is used by UK pension schemes when making assumptions about future mortality rates.

2020 and 2021 saw significantly higher mortality due to the coronavirus pandemic, 14% higher than mortality in 2019. In 2022, England & Wales standardised mortality rates show a decrease, with mortality rates being 3% lower than in 2021. The 2020 and 2021 mortality rates are therefore unlikely to be indicative of future experience. Use of them would impact actuarial calculations and as such, the CMI 2023 model places no weight on this data, consistent with the CMI 2022 model.

Mortality in 2022 and 2023 was less volatile, evident in the 3% decrease in 2022, albeit still higher than pre-pandemic levels. However, it is clear that mortality experience is returning to a level close to pre-pandemic years. With this in mind, a consultation with CMI model users resulted in the CMI 2023 model placing a weight of 15% on 2022 and 2023 data and 0% of 2020 and 2021 data.

Overall, the CMI 2023 model has lower mortality improvements than the 2022 model at most ages, decreasing life expectancies by around 1 month. In isolation, this translates to an approximate decrease of less than 1% in liabilities for an average scheme.

It is also important to note that the CMI 2023 model uses Office for National Statistics ("ONS") 2021 census data. This differs to the CMI 2022 model, which used CMI estimated population data.

The "S4" Series mortality tables were released over the year by the CMI, which are based on data from 1 January 2014 to 31 December 2019, excluding years affected by COVID-19.

Consultation on Changes to FRS 102

In December 2022 the Financial Reporting Council issued FRED 82 which proposes a number of changes to FRS 102 and other accounting standards following the second review of the standards. These updates include small clarifications and improvements as well as a new model for revenue recognition in FRS 102 and 105 and a new model for lease accounting in FRS 102. The proposed effective date of the amendments set out in the FRED is 1 January 2025. Comments on the suggested changes were requested by 30 April 2023.

In March 2023 the FRC published their 3-Year plan, within which they emphasised that one of their priorities for this year is completion of the periodic review of FRS 102.

In March 2024 the FRC issued improvements to the standards with an effective date of 1 January 2026, with the purpose of improving access to capital and growth for businesses by updating the way leases are accounted for.

ARGA

The government has announced plans to replace the FRC with ARGA (Audit, Reporting and Governance Authority), a new statutory regulator. At the end of July 2022, the Financial Reporting council launched a consultation on its draft proposals on how the new regulator should be funded. ARGA will be funded through a mandatory levy on industry. Their new powers will include directing companies to restate their accounts without going to court.

Within their 3-Year plan the FRC confirmed that the expected date of transition from the FRC to ARGA has been pushed back from 2023 to 2024. There is still some uncertainty regarding when the ARGA Bill will receive time in Parliament.

Over the year, the FRC published a Position Paper detailing their plan to reform the UK's audit and corporate governance framework.

The FRC issued their new single UK Corporate Governance Code in January: UK Corporate Governance Code 2024 (frc.org.uk)

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