Improving your pension balance sheet and COVID-19 and your pension options

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11 May 2020

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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. SHPS and financial accounting
   a. Background
   b. What has happened since 31 March 2019?
   c. The FRS 102 SHPS pension disclosure process
   d. How to make changes to your pension disclosures

2. COVID-19 and pensions
   a. Overview
   b. Employer actions
   c. Employee actions
   d. Communication to employees

1. SHPS and financial accounting

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1a. Background

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Financial accounting in a nut shell

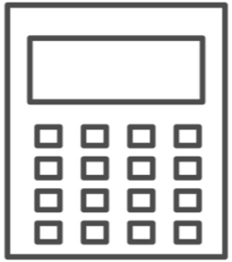
- At year end date, each Association's share of their SHPS's assets and liabilities are calculated for inclusion in each Association's financial statements
- Applicable for SHPS employers since 31 March 2019
- More transparent than previous method, consistent with LGPS and other funded defined benefit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

How do you carry out an actuarial valuation?

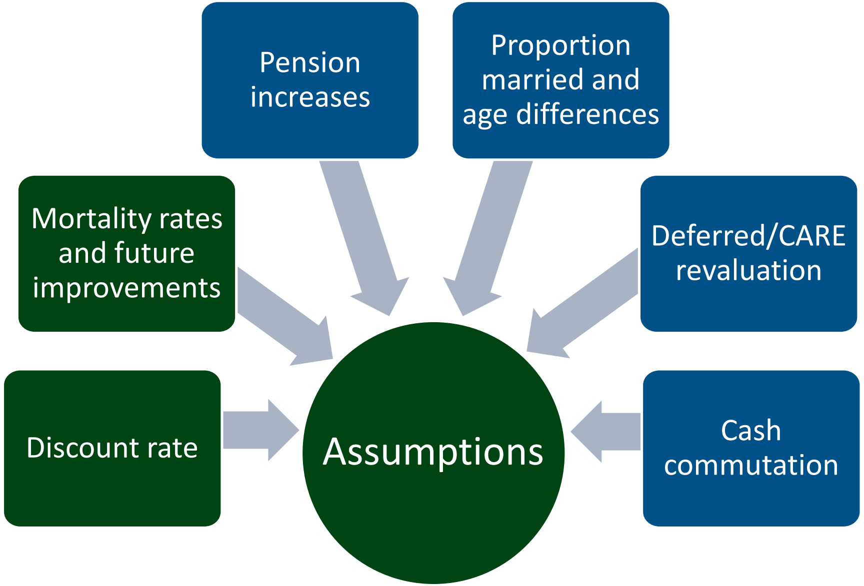
For benefits promised to date it is a comparison of the **present values** of:

Assets V Benefits

Simple……in theory ?!



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 2019?

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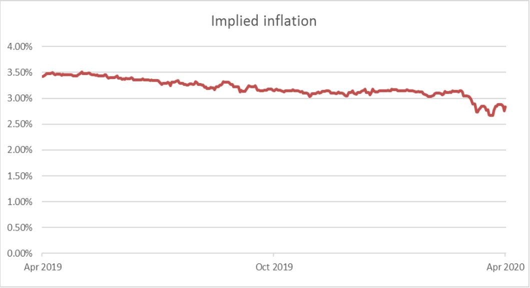
Financial markets over the 12 months to 31 March 2020



COVID-19 has had a significant impact

What does it mean for your FRS 102 accounting disclosures?

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AA corporate bond yields

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

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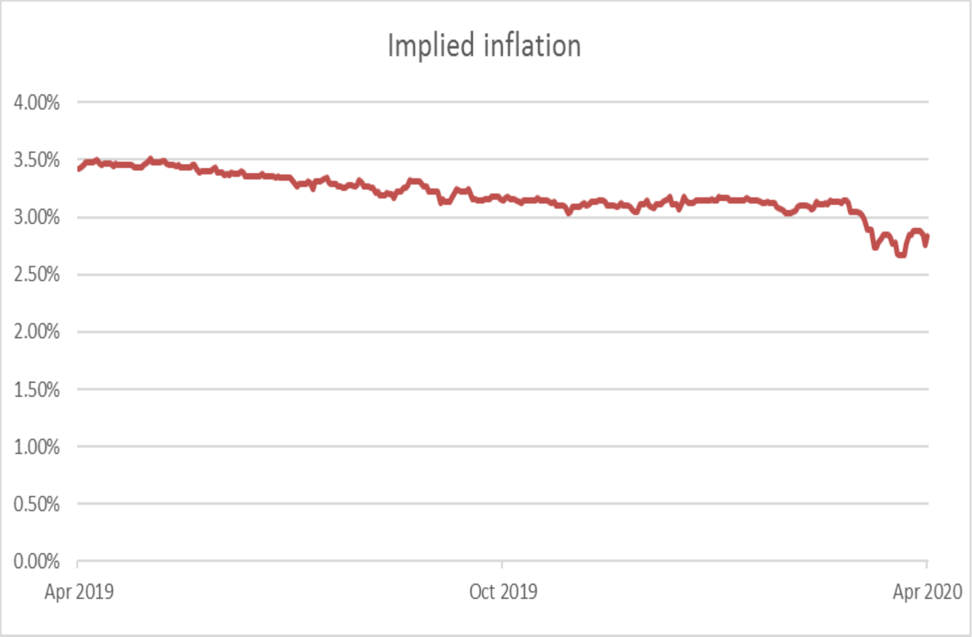
Implied inflation

- Markets long term expectation of inflation
- Pensions before and after retirement are increased by inflation
- In isolation the lower the inflation assumption the lower your pension liabilities
- Has a smaller impact than the discount rate assumption



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Global equity markets

- If assets fall in value then in isolation the pension liability disclosed on your balance sheet will increase
- SHPS has a very diversified investment portfolio
- Should have mitigated some of these falls in investments

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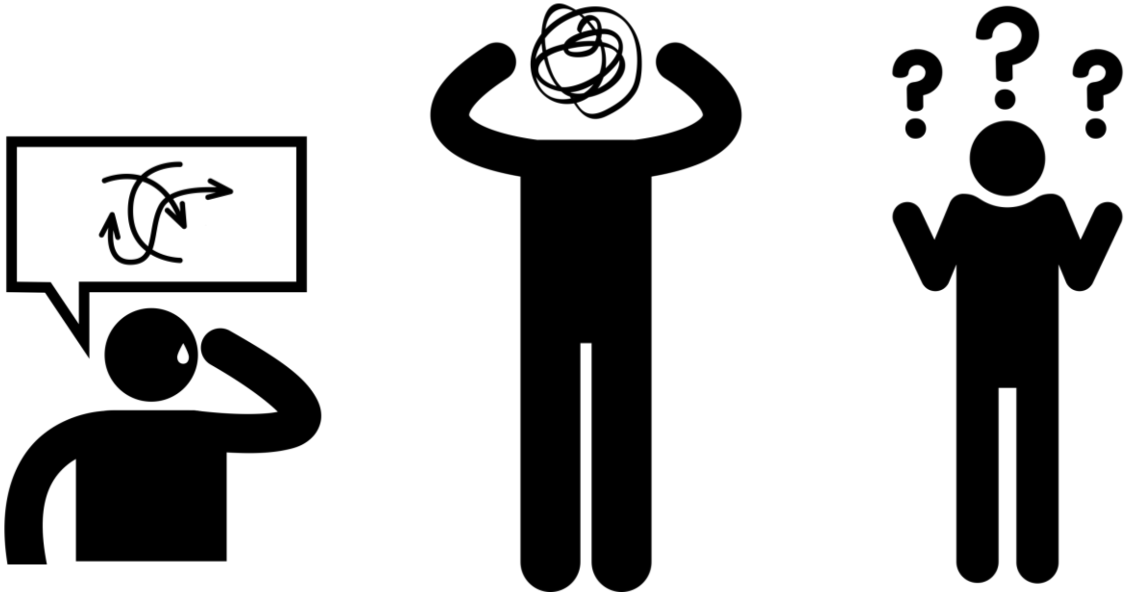
What does this mean for my pension disclosures?



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1c. The FRS 102 SHPS pension disclosure process

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The process for 2020

- TPT will provide you with your 31 March 2020 SHPS FRS pension disclosures w/c 11 May 2020.
- You can accept these and insert them into your accounts.
- You can make changes to the assumptions and re-run the disclosures using the modelling tools provided by TPT.
- How do you know what changes to make and how can you justify these?

1d. How to make changes to your pension disclosures

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Independent actuarial advice

- Independent actuarial advice will help
  - Identify the changes
  - Assess the financial impact of these
  - Provide sufficient justification for auditors
- Impact of changes can be quite significant
- Let's look at a case study where actuarial advice was provided to a SHPS employer last year……….

Case study - initial results as disclosed by TPT

	31 March 2019 (£000s)	31 March 2018 (£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 assumptions set by TPT's actuaries

These can be altered

These cannot be altered

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Case study - proposed key assumption changes

	Proposed assumptions (TPT)	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%

Case study - proposed key assumption changes

	Proposed assumptions (TPT)	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 S2PxA tables relevant to year of birth, CMI 2017 projections, subject to long term trend rate of 1.25% p.a. for males and 1.00% p.a. for females	103% of S2PxA tables relevant to year of birth, CMI 2018 projections, subject to long term trend rate of 1.25% p.a. for males and 1.00% p.a. for females	c2% reduction
Overall impact	-	-	c9% reduction

Using most up to date mortality analysis

Most up to date mortality analysis assumes we do not live as long as we previously expected and therefore this reduces the value placed on the Association's pension promises to members

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Case study - revised results

	31 March 2019 - revised (£000s)	31 March 2019 - 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

Changes can be justified as independent actuarial advice received

Need to be agreed by the Association’s Board/Committee

Need to be approved by the Association's Auditor

Changes then incorporated into Association’s Financial Statements

Independent actuarial advice is key

2. COVID-19 and pensions

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Overview

- More flexibility for employers over the deferral and suspension of employer defined benefit pension contributions
- Regulations relaxed over temporary changes to employee contributions
- However less flexibility in multi-employer pension schemes such as SHPS and LGPS

Employer actions

Defined benefit
Can request a suspension of deficit reduction contributions for up to three months – no requests from SHPS employers to date

Defined contribution
Put in place lower employer contribution tier - takes two months to implement with SHPS

Still need to meet auto enrolment minimum contribution rates

Salary sacrifice for employee pension contributions
Ensure furloughed employees (not topped up) are taken out of salary sacrifice arrangements otherwise employer pays employee contribution in addition to their own

Employee actions

Defined benefit
Move to a lower accrual tier (if available) and hence pay lower contributions

Opt out

Defined contribution
Move to a lower contribution tier (if available)

Opt out

Communication to employees

- Reassurance
- Pensions for many are a long term game
- No impact to DB pensions
- Protections in place for DC members close to retirement
- Highlight options available to employees
- Go online via their TPT online BenPal access

Questions

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