Pensions Accounting Update

As at 31 March 2024

SPENCE

Overview

This guide is a reference for companies preparing their 31 March 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.

Market movements over the last 12 months mean most companies should be reporting an improved DB funding position on their accounting basis at 31 March 2024. A modest increase in corporate bond yields and reduction in market implied inflation over the year has reduced liabilities by 1-2%. Meanwhile, all the main asset classes had positive returns over the year, increasing asset values. EPS has seen a 6% 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 31 March 2023 to 31 March 2024

EPS Assumption	31 March 2024	31 March 2023	Change over the Year	Change in Liabilities [1]
Discount Rate	4.80% p.a.	4.73% p.a.	0.07% p.a.	-1.0%
Inflation Assumption(s)	3.60% p.a.	3.66% p.a.	-0.06% p.a.	-0.3%[2]
TOTAL[3]				**-1.3%**

Discount Rate

A modest increase in the corporate bond yield will result in a higher discount rate and lower liabilities, all other things being equal, at 31 March 2024.

Bond yields generally increased over the year up until September as a result of the Bank of England (BoE) further increasing base rates in order to tackle the high levels of inflation. Bond yields then decreased until the end of December as expectations of further increases to the base rate set by the Bank of England decreased, before increasing over the quarter again.

The duration of the iBoxx over 15-year AA rated corporate bond index was 15 years as at both 31 March 2023 and 31 March 2024.

Inflation

A modest decrease in gilt market implied inflation will result in a lower inflation assumption and lower liabilities, all other things being equal, at 31 March 2024.

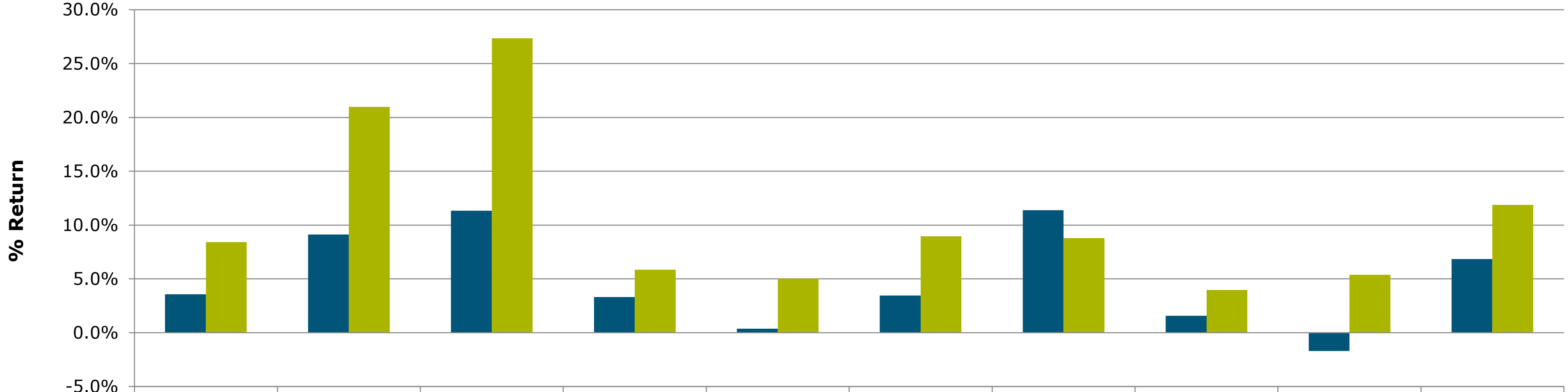
Short term expectations of future inflation increased over the year while expectations of longer term inflation decreased.

Mortality

The most recently available mortality base tables published by the Continuous Mortality Investigation ("CMI") bureau are the S3 base tables, and the CMI 2022 model. The CMI 2022 (core) model applies a weighting of 25% to the mortality data from 2022 and, consistent with the CMI 2021 (core) model, these tables continue to apply no weighting to mortality data from 2020 and 2021. Therefore, the CMI 2022 (core) tables are the first set of future mortality improvement tables that make an allowance for data since the Covid pandemic, albeit the allowance is a partial one

1. Assumes EPS liabilities have average duration of 14 years. No allowance for cashflows has been made.
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 31 March 2023 to 31 March 2024



	UK Equity	Global Equity	US Equity	Emerging Market Equity	Property	Hedge Funds	Commodities	Infrastructure	Corporate Bonds	Gilts
Quarter Return	3.57%	9.12%	11.34%	3.30%	0.37%	3.46%	11.37%	1.56%	-1.70%	6.84%
Year Return	8.43%	20.98%	27.35%	5.86%	5.03%	8.97%	8.79%	3.98%	5.38%	11.87%

Chart 1 - Return on Major Asset Classes Source: Morningstar

Equities generally performed well over the year, with most markets posting returns in excess of 5% p.a.

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

Corporate bonds posted a negative return over the quarter, but a positive return over the year.

NOTES

Effect on Typical 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 14 as at 31 March 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.

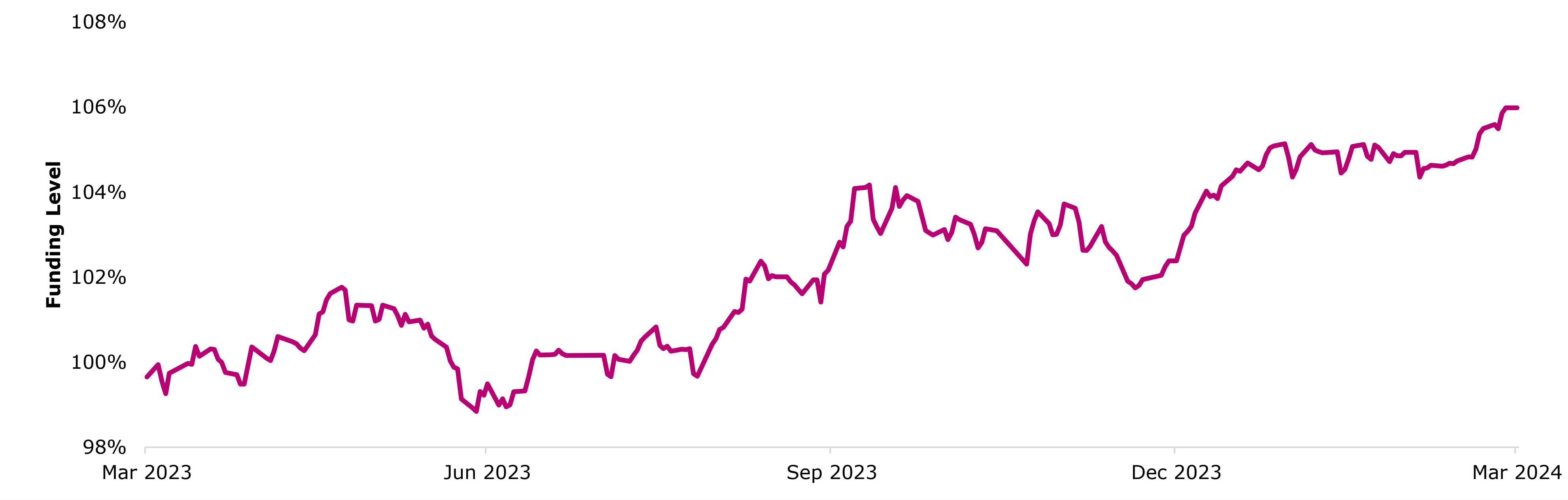


Chart 2 - Daily Movements in EPS funding level

The funding level of EPS increased by 6% over the year. 1-2% of this improvement is from liability falls driven by a modest increase in the discount rate and reduction in the inflation assumption. The rest of the improvement is from asset returns over and above the interest on the liabilities.

Recent Developments

Market Conditions

The Bank of England has increased the base rate substantially over the past year and continued to hold it over the quarter at 5.25% p.a. in March 2024. Overall, base rates have increased by 1.00% since March 2023, with UK inflation falling to its lowest level in two years and expected to fall further over the next year.

Updates from the FRC, Chancellor and the OBR

Amidst this economic uncertainty, the FRC has set out its expectations for the way that companies report results. They reference the increased need to include detailed user-friendly explanations of the positions taken related to impairments, and judgements and estimates.

The Chancellor delivered his Autumn statement on 22 November 2023. The statement supports recent government decisions to reduce borrowing, since inflation has fallen significantly. It also illustrates the stronger than expected recent economic growth, which is forecasted to continue.

Alongside this, the Office for Budget Responsibility (OBR) presented an economic and fiscal forecast to Parliament. They expect that government policies will continue to bring deflationary pressures over the next year.

The Spring Budget update published in March stated that inflation is continuing to fall, economic growth is rising and debt is expected to decrease.

CMI Model updates

The Continuous Mortality Investigation (CMI) released their Mortality Projections Model, “CMI 2022”, last year. 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 2022 model places no weight on this data.

Mortality in 2022 was less volatile, evident in the 3% decrease, albeit still higher than pre-pandemic levels. With this in mind, a consultation with CMI model users resulted in the CMI 2022 model placing a weight of 25% on 2022 data and 0% of 2020 and 2021 data.

Overall, the CMI 2022 model has lower mortality improvements than the 2021 model at most ages, decreasing life expectancies by around 5-6 months. In isolation, this translates to an approximate decrease of between 1% and 3% in liabilities for an average scheme.

In January, CMI updated their population estimates to include more detailed results of the 2021 census issued in November 2023, causing lower mortality assumptions in 2021, 2022 and 2023.

The CMI 2023 model was released in April 2024. It will likely be used for financial reporting after 31 March 2024.

The "S4" Series mortality tables were released over the quarter 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.

Last quarter, 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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